

CHAPTER 10

Table of Contents

<i>Paragraph</i>	<i>Page</i>
10-000 Preparation And Distribution Of Audit Reports	
10-001 Scope of Chapter	1001
10-100 Section 1 --- Audit Report Quality	
10-101 Introduction.....	1001
10-102 Importance of Audit Report Quality.....	1001
10-103 Characteristics of a Quality Audit Report	1001
10-103.1 Timeliness of Reports	1002
10-103.2 Report Content.....	1002
10-103.3 Audit Opinion - General	1004
10-104 Good Writing Techniques for Effective Audit Reports.....	1006
10-104.1 Planning the Audit Report.....	1007
10-104.2 Organizing the Audit Report.....	1007
10-104.3 Drafting the Audit Report	1008
10-104.4 Clarity and Precision in the Audit Report	1008
10-104.5 Responsiveness to the Customer in the Audit Report	1008
10-104.6 Readability of the Audit Report.....	1009
10-104.7 The Visual Impact of the Audit Report.....	1010
10-104.8 Active and Passive Voice	1010
10-104.9 Misplaced Modifiers and Pronouns	1011
10-104.10 The Requestor's Perspective.....	1011
10-104.11 Final Steps	1012
10-200 Section 2 --- Audit Report Format and Contents (General)	
10-201 Introduction (Reports-General)	1013
10-202 Reporting of Audit Results (Reports-General).....	1013
10-203 Report Administrative Requirements (Reports-General)	1013
10-203.1 Paper	1013
10-203.2 Margins	1013
10-203.3 Typing	1013
10-203.4 Paragraphing	1013
10-203.5 Upper Case Lettering.....	1014
10-203.6 Date	1014

<i>Paragraph</i>	<i>Page</i>
10-203.7 Page Numbering	1014
10-203.8 Numbering Audit Reports	1014
10-203.9 Report Assembly and Reproduction	1014
10-203.10 Electronic Distribution of Reports	1014
10-203.11 Citations of Legal Opinions	1015
10-203.12 Insignificant Amounts/ Elimination of Cents	1016
10-203.13 Protection of Report Information.....	1016
10-203.14 Report Terminology	1016
10-203.15 Spreadsheets	1017
10-204 Report Format (Reports-General)	1017
10-205 Cover Sheets	1017
10-205.1 General	1017
10-205.2 Cover Sheets for Reports on Classified Subjects.....	1018
10-206 Addressees (Reports-General)	1018
10-206.1 Prime Contract Report Addressees	1018
10-206.2 Subcontract and Intracompany Report Addressees	1019
10-206.3 Form of Address	1019
10-206.4 "THRU" Addressing.....	1019
10-206.5 Attention Lines	1019
10-207 Subject Line (Reports-General).....	1019
10-208 References Section (Reports-General)	1019
10-209 Table of Contents (Reports-General)	1020
10-210 Report Narrative (Reports-General).....	1020
10-210.1 Subject of Audit.....	1020
10-210.2 Executive Summary	1022
10-210.3 Scope of Audit	1022
10-210.4 Qualifications.....	1024
10-210.5 Results of Audit	1026
10-210.6 Explanatory Notes.....	1028
10-210.7 Contractor Organization and Systems.....	1029
10-211 DCAA Personnel and Report Authorization (Reports-General)	1029
10-212 Report Distribution and Restrictions (Reports-General)	1030
10-212.1 General.....	1030
10-212.2 Release of Audit Reports to the Contractor	1030
10-212.3 Release of Subcontract Audit Report to the Higher-Tier Contractor --- Proposals or Other Cost Submissions.....	1032

<i>Paragraph</i>	<i>Page</i>
10-213 Appendixes (Reports-General).....	1033
10-214 Supplemental Reports	1033
10-214.1 Criteria for Use	1033
10-214.2 General Requirements for Supplemental Reports	1034
10-214.3 Supplemental Report Format.....	1035
10-214.4 Audit Report Cover Sheet	1035
10-214.5 Report Narrative	1035
10-214.6 Revised Report Format.....	1036
10-215 Transmittal Memorandums and Routing	1036
Figure 10-2-1 Defense Contract Audit Agency Audit Report	1037
Figure 10-2-2 Subject of Audit.....	1038
Figure 10-2-3 DCAA Personnel.....	1039
Figure 10-2-4 Audit Report Distribution and Restrictions	1040
10-2S1 Supplement -- E-mail Distribution of Reports	1041

10-300 Section 3 --- Audit Reports on Price Proposals

10-301 Introduction (Proposal Reports).....	1042
10-302 Report Format and Contents (Proposal Reports).....	1042
10-303 Addressing and Distributing Reports (Proposal Reports)	1042
10-303.1 Reports on Prime Contract Proposals	1042
10-303.2 Reports on Intracompany and Subcontract Proposals	1043
10-304 Report Narrative (Proposal Reports).....	1043
10-304.1 Subject of Audit.....	1043
10-304.2 Executive Summary.....	1043
10-304.3 Scope of Audit	1044
10-304.4 Qualifications.....	1045
10-304.5 Results of Audit	1048
10-304.6 Audit Opinion - Pricings	1048
10-304.7 Contractor's Submission and Audit Evaluation	1051
10-304.8 Questioned, Unsupported and Unresolved Cost.....	1052
10-304.9 Difference	1054
10-304.10 Additional Remarks	1054
10-305 Report Narrative (Parts of a Proposal).....	1055
10-305.1 Subject of Audit of Parts of a Proposal.....	1056
10-305.2 Executive Summary of Parts of a Proposal	1056
10-305.3 Scope of Audit of Parts of a Proposal.....	1056
10-305.4 Results of Audit of Parts of a Proposal.....	1057

<i>Paragraph</i>	<i>Page</i>
10-306 Contractor Organization and Systems (Proposal Reports)	1057
10-307 Report Distribution and Restrictions (Proposal Reports).....	1058
10-307.1 Release of Audit Report to the Contractor	1058
10-307.2 Release of Subcontract Audit Report to the Higher-Tier Contractor	1058
10-307.3 Release of Audit Report to FMS Customers	1059
10-308 Appendixes (Proposal Reports).....	1059
10-308.1 Appendix --- Other Matters To Be Reported	1059
10-308.2 Appendix --- Subcontracts Requiring Contractor Cost Analyses.....	1059
10-308.3 Appendix --- Incorporation of Government Technical Reports.....	1060
10-400 Section 4 --- Audit Reports on Operations and Internal Control (System Audits)	
10-401 Introduction (System Reports)	1061
10-402 Nature of Reports (System Reports).....	1061
10-403 Report Format and Contents (System Reports).....	1061
10-404 Cover Sheet (System Reports).....	1062
10-405 Subject of Audit (System Reports)	1062
10-406 Executive Summary (System Reports).....	1063
10-407 Scope of Audit (System Reports).....	1063
10-408 Results of Audit (System Reports).....	1064
10-408.1 Economy and Efficiency Audits (System Audits)	1064
10-408.2 Internal Control Audits (System Audits).....	1066
10-409 Statement of Condition and Recommendations (System Reports)	1068
10-410 Contractor Organization and Systems (System Reports)	1069
10-411 DCAA Personnel (System Reports)	1070
10-412 Distribution and Restrictions (System Reports).....	1070
10-412.1 Distribution to Contractor.....	1070
10-412.2 Distribution to Other In-Plant Government Representatives....	1070
10-412.3 Distribution to Procurement Offices	1070
10-412.4 Additional Distribution of Reports on Subcontractors.....	1071
10-412.5 Distribution to Other DCAA Offices	1071
10-412.6 Additional Distribution---NASA Contractors.....	1071
10-413 Real Time Reporting (Flash Reports)	1071
10-413.1 Subject of Evaluation	1071

Paragraph

Page

10-413.2 Scope of Evaluation.....	1072
10-413.3 Results of Evaluation.....	1072
10-413.4 Contractor Organization and System Section	1073
10-413.5 Impact on Other Related Audits.....	1073
10-500 Section 5 --- Audit Reports on Annual Incurred Costs	
10-501 Introduction (Incurred Cost Reports)	1074
10-502 Nature of Reports (Incurred Cost Reports)	1074
10-503 Report Format and Content (Incurred Cost Reports)	1075
10-504 Report Narrative (Incurred Cost Reports)	1075
10-504.1 Subject of Audit	1075
10-504.2 Executive Summary	1076
10-504.3 Scope of Audit	1076
10-504.4 Qualifications.....	1077
10-504.5 Results of Audit	1077
10-504.6 Contractor Organization and Systems.....	1080
10-504.7 DCAA Personnel and Report Authorization.....	1081
10-505 Appendixes (Incurred Cost Reports)	1081
10-505.1 Appendix - Other Matters to be Reported	1081
10-505.2 Appendix - Billing Rates.....	1081
10-505.3 Other Appendixes	1081
10-506 Reporting on Reviews of Low-Risk Incurred Cost Submissions.....	1081
10-506.1 Standard of Review	1081
10-506.2 Report Elements.....	1081
10-507 Distribution (Incurred Cost Reports).....	1082
Figure 10-5-1 Schedule Of Unallowable Costs Subject To Penalty	1084
Figure 10-5-2 Home Office Expense Schedule Of Unallowable Costs Subject To Penalty	1085

10-600 Section 6 --- Audit Reports on Postaward Audits of Cost or Pricing Data

10-601 Introduction (Postaward Reports)	1086
10-602 Nature and Timing of Reports (Postaward Reports)	1086
10-603 Report Format and Contents (Postaward Reports)	1086
10-604 Cover Sheet (Postaward Reports)	1087
10-604.1 General Information.....	1087
10-604.2 Release of Subcontract Audit Report to the Higher-Tier Contractor	1087

<i>Paragraph</i>	<i>Page</i>
10-605 Addressing and Distributing Reports (Postaward Reports).....	1087
10-605.1 Addressing and Distributing Prime Contract Audit Reports .	1087
10-605.2 Addressing and Distributing Subcontract and Intracompany Audit Reports	1088
10-606 Narrative (Postaward Reports).....	1088
10-606.1 Subject of Audit	1088
10-606.2 Executive Summary	1090
10-606.3 Scope of Audit	1090
10-606.4 Qualifications.....	1091
10-606.5 Results of Audit	1092
10-606.6 Systemic and/or Unsatisfactory Conditions	1093
10-606.7 Additional Remarks	1094
10-606.8 Contractor Organization and Systems.....	1095
10-607 Appendixes (Postaward Reports)	1095
10-607.1 Chronology of Significant Events	1095
10-607.2 Contractor's Written Remarks	1095
10-6S1 Supplement --- Distribution (Postaward Reports).....	1096
 10-700 Section 7 --- Audit Reports on Termination Settlement Proposals	
10-701 Introduction (Termination Reports)	1097
10-702 Report Format and Contents (Termination Reports)	1097
10-703 Subject of Audit (Termination Reports).....	1097
10-704 Executive Summary (Termination Reports).....	1098
10-705 Scope of Audit (Termination Reports).....	1098
10-706 Results of Audit (Termination Reports).....	1098
10-706.1 Audit Opinion - Termination.....	1098
10-706.2 Exhibits and Schedules.....	1098
10-706.3 Questioned Costs.....	1098
10-706.4 Unresolved Costs	1098
10-706.5 Additional Remarks.....	1099
10-707 Contractor Organization and Systems (Termination Reports).....	1099
10-708 Distribution (Termination Reports).....	1099
 10-800 Section 8 --- Audit Reports on Cost Accounting Standards Matters	
10-801 Introduction (CAS Reports).....	10100
10-802 Nature of Reports (CAS Reports).....	10100
10-803 Report Format and Content (CAS Reports)	10100

10-804 Audit Reports - Adequacy of Initial Disclosure Statement (Disclosure Statement Reports)	10100
10-804.1 Subject of Audit	10101
10-804.2 Executive Summary	10101
10-804.3 Scope of Audit	10101
10-804.4 Qualifications	10101
10-804.5 Results of Audit	10101
10-804.6 Contractor Organization and Systems	10102
10-804.7 Report Distribution and Restrictions - Adequacy	10102
10-805 Audit Reports – Compliance of Initial Disclosure Statement (Disclosure Statement Reports)	10102
10-805.1 Subject of Audit	10102
10-805.2 Executive Summary	10103
10-805.3 Scope of Audit	10103
10-805.4 Qualifications	10103
10-805.5 Results of Audit	10103
10-805.6 Contractor Organization and Systems	10104
10-805.7 Report Distribution and Restrictions – Compliance	10104
10-806 Audit Reports on Concurrent Adequacy and Compliance Audits of Revised Disclosure Statements (Concurrent CAS Reports)	10104
10-806.1 Subject of Audit	10104
10-806.2 Executive Summary	10105
10-806.3 Scope of Audit	10105
10-806.4 Qualifications	10105
10-806.5 Statement of Changes	10105
10-806.6 Results of Audit	10106
10-806.7 Contractor Organization and Systems	10107
10-806.8 Report Distribution and Restrictions - Concurrent	10108
10-807 CAS Compliance Audit Reports (CAS Compliance Reports)	10108
10-807.1 Subject of Audit	10108
10-807.2 Scope of Audit	10108
10-807.3 Qualifications	10109
10-807.4 Results of Audit	10109
10-807.5 Report Distribution and Restrictions - Compliance	10109
10-808 Audit Reports on Noncompliance with Disclosed or Established Practices, CAS, or FAR (Noncompliance Reports)	10109

<i>Paragraph</i>	<i>Page</i>
10-808.1 Subject of Audit	10109
10-808.2 Executive Summary	10110
10-808.3 Scope of Audit	10110
10-808.4 Qualifications	10111
10-808.5 Results of Audit	10111
10-808.6 Contractor Organization and Systems	10112
10-808.7 Report Distribution and Restrictions - Noncompliance	10112
10-809 Cost Impact Statements (CAS Cost Impact Reports)	10112
10-809.1 Subject of Audit	10112
10-809.2 Executive Summary	10113
10-809.3 Scope of Audit	10113
10-809.4 Qualifications	10113
10-809.5 Results of Audit	10113
10-809.6 Contractor Organization and Systems	10114
10-809.7 Report Distribution and Restrictions – CAS Cost Impact..	10114
10-810 Distribution and Restrictions	10114
Figure 10-8-1 Statement of Contractor's Proposed Contract Price Adjustments.....	10115
10-900 Section 9 --- Audit Reports on Contract Audit Closing Statements, Other Contract Closings, and Price Redeterminations	
10-901 Introduction	10116
10-902 Cumulative Allowable Cost Worksheet (CACWS), Comparable Worksheets, or Contract Audit Closing Statement Reports (CACS)	10116
10-903 Quick Closeout Procedure Reports	10117
10-904 Repricing Proposal Reports for Incentive and Redeterminable Fixed- Price Contracts	10118
10-905 Report Distribution – CACS and Repricings	10118
10-1000 Section 10 --- Reports on Application of Agreed-Upon Procedures	
10-1001 Introduction (Agreed - Upon Procedures)	10120
10-1002 Nature of Reports (Agreed - Upon Procedures)	10120
10-1003 Report Format and Contents (Agreed - Upon Procedures)	10120
10-1004 Report Narrative (Agreed - Upon Procedures)	10120
10-1005 Subject of Application of Agreed - Upon Procedures	10121
10-1006 Executive Summary (Agreed - Upon Procedures)	10121
10-1007 Scope of Application of Agreed - Upon Procedures	10121

10-1008 Restrictions on Procedures (Agreed - Upon Procedures).....	10122
10-1009 Results of Application of Agreed - Upon Procedures	10122
10-1010 Contractor Organization and Systems (Agreed - Upon Procedures)	10124
10-1011 Report Distribution and Restrictions (Agreed - Upon Procedures)	10124

10-1100 Section 11 --- Audit Reports on Price Adjustment Proposals or Claims

10-1101 Introduction (Claim Reports).....	10125
10-1102 Proper Terms (Claim Reports).....	10125
10-1103 Report Format and Contents (Claim Reports)	10125
10-1103.1 General Format	10126
10-1103.2 Addressing and Distributing Reports	10126
10-1104 Report Narrative.....	10126
10-1104.1 Subject of Audit	10126
10-1104.2 Executive Summary	10126
10-1104.3 Scope of Audit	10126
10-1104.4 Qualifications	10127
10-1105 Results of Audit (Claim Reports)	10127
10-1105.1 Exhibits and Schedules	10127
10-1105.2 Unsatisfactory Conditions or Other Audit Recommendations	10128
10-1105.3 Additional Remarks	10128
10-1106 Contractor Organization and Systems (Claim Reports)	10128
10-1107 Appendixes (Claim Reports).....	10129
10-1107.1 Chronology of Significant Events (See Figure 10-11-1).....	10129
10-1107.2 Contractor's Written Comments.....	10129
10-1107.3 Observations on Entitlement.....	10129
Figure 10-11-1 (Ref. 10-1107.1) Evaluation of Proposal or Claim for Price Adjustment	10130

10-1200 Section 12 --- Reports on Other Areas

10-1201 Introduction (Other Reports)	10131
10-1202 Additional Guidance (Other Reports)	10131
10-1203 Report Format and Contents (Other Reports)	10132
10-1204 Report Narrative (Other Reports).....	10132
10-1204.1 Subject of Audit.....	10132
10-1204.2 Executive Summary	10132
10-1204.3 Scope of Audit	10132

*Paragraph**Page*

10-1204.4 Qualifications.....	10133
10-1204.5 Results of Audit	10133
10-1204.6 Contractor Organization and Systems (Other Reports).....	10134

CHAPTER 10**10-000 Preparation And Distribution Of Audit Reports****10-001 Scope of Chapter**

This chapter discusses the importance of DCAA audit reports and provides guidance in preparing quality reports. It presents standard report formats and describes

the elements common to all audit reports. The chapter also includes specific instructions on format and content of audit reports for various types of major audit assignments.

10-100 Section 1 --- Audit Report Quality

Users of CAM Chapter 10 and the "shell" and program audit reports incorporated in Agency guidance should recognize that "standard" report language is provided as an example, not as mandatory wording. The DCAA auditor should exercise judgment in tailoring report language to the situation being reported.

10-101 Introduction

a. This section emphasizes the importance of audit report quality and describes the characteristics of a quality audit report. It also includes a brief discussion of some important report writing techniques to assist auditors in preparing quality audit reports.

b. Written audit reports are to be submitted to the appropriate officials of the organizations requiring or arranging for the audits. Copies of the reports should be sent to other officials who may be responsible for taking action on audit findings and recommendations, and to others authorized to receive such reports.

c. The issuance of a report is not intended to limit or prevent discussions of findings, judgments, conclusions, and recommendations with persons, including contractor personnel and management, who have responsibilities involving the area being audited. Except for conclusions and recommendations to the contracting officer with respect to reports covering forecasted costs (see 10-212.2c.) such discussions are encouraged (see 4-300).

d. In addition to the importance of the audit report in complying with professional standards, written reports are nec-

essary to make the auditor's findings and recommendations less susceptible to misunderstanding. A written report

- communicates results to responsible government procurement officials and occasionally to higher levels in the Department of Defense;
- is used in negotiation proceedings; and
- facilitates follow-up to determine whether appropriate measures have been taken in response to the auditor's findings and recommendations.

10-102 Importance of Audit Report Quality

Reports of some kind are necessary in all occupations. The importance of the DCAA audit report cannot be overemphasized. Audit reports are the principal means of conveying our audit results to contracting officers and other interested parties. Because effective reporting is a major factor in building and maintaining confidence in DCAA audit activities, we must continually strive to produce high quality reports. Auditors must exercise due care in preparing, reviewing, and processing reports to provide reasonable assurance that reports contain no grammatical and mathematical errors, and no errors of fact, logic, or reasoning.

10-103 Characteristics of a Quality Audit Report

The DCAA audit report must satisfy generally accepted government auditing standards (GAGAS) as outlined in 2-400 and 2-600. A good report will present the

scope and results of a quality audit in an objective, concise, complete, and easily understood manner. Report findings and conclusions must be accurate and reasonable, must not be unfair or misleading, and must be supported by sufficient objective evidential matter. The report should also reflect common sense and good judgment in dealing with materiality, the level of detail provided and the requestor's needs.

10-103.1 Timeliness of Reports

a. Reports are to be issued on or before the dates specified and, in any event, as promptly as possible. To be useful, the audit report must be timely. The auditor should realize that every day of delay in issuing the report diminishes its value. Therefore, he or she should plan and conduct the work with the objective of reporting the results not later than the date the report is due.

b. The auditor should consider reporting significant matters to appropriate officials during the course of the audit work. Such reporting is not a substitute for a final written report, but it does alert officials to matters needing correction at an earlier date.

c. When a specified reporting date does not allow sufficient time to perform a complete audit (especially major proposals, sensitive evaluations, or where there is potential for significant audit findings) the auditor should:

Request a time extension detailing the areas where work will be incomplete because of the time restrictions.

If the extension is not granted, issue a qualified report advising that audit effort is continuing.

Alert the ACO and PCO of significant findings resulting from this continuing audit effort. Issue supplemental report(s) confirming these findings until it is clear that reporting the findings can have no further impact on the outcome of the negotiations.

d. When time limitations or weaknesses in supporting documentation make it impossible to submit a complete report and the audit work is not to be continued, the auditor should report whatever information is

available, with appropriate comments as to the audit scope, within prescribed time limits.

e. Care should be taken to ensure that the report cover sheet appropriately contains all key elements (Figure 10-2-1). A report mistakenly sent to an inappropriate address may either delay the negotiation process or render the report useless.

10-103.2 Report Content

The audit report should be easily understood. The subject of audit should clearly identify the area, system or the proposal being audited, reviewed or having agreed-upon procedures applied. Present the scope and the auditor's findings and conclusions objectively and completely, with appropriate support for positions taken, and provide recommendations for improvement, whenever appropriate.

a. Accuracy, Completeness, and Fairness. Report preparation, review, and processing procedures should be applied to produce reports that contain no errors of fact, logic, or reasoning. The need for accuracy is based on the need to be fair and impartial in reporting and to assure readers that what is reported is reliable. One inaccuracy can cast doubt on the validity of an entire report and can divert attention from the substance of the report. Although reports should be concise, they should not be so concise that they do not fully inform the user. Reports should contain sufficient information about findings, conclusions, and recommendations to promote adequate understanding of the matters reported and to provide convincing, but fair, presentations in proper perspective. Sufficient amounts of background information should also be included. Readers should not be expected to possess all the facts that the auditor has. Therefore, reports should not be written on the basis that the bare recitals of facts make the conclusions obvious or inescapable. If the auditor has conclusions or opinions that he or she wishes to present, the auditor should state them clearly and specifically. Presenting valid findings in their true light is essential to the accuracy and the integrity of the re-

port. These findings must be presented so they can be clearly understood.

b. Objectivity. Findings should be presented in an objective and unbiased manner and should include enough information on the subject matter to give readers proper perspective. Reports should be fair and not misleading and, at the same time, emphasize matters needing attention. The auditor should guard against any tendency to exaggerate or overemphasize deficient performance noted during the audit. The information needed to provide proper report balance and perspective should include:

- appropriate information as to why the examination was made;
- information about the size and nature of the activities or contract(s) to which findings relate; and
- correct and fair descriptions of findings so as to avoid misinterpretation.

Where statistical sampling or other quantitative methods are used, a comment to that effect should be made a part of the auditor's explanation of the individual cost elements involved. However, detailed procedural information should not necessarily be given. See 4-605 for a discussion of sampling policy.

c. Adequate Support. Sufficient objective evidence to demonstrate or provide the basis for each matter reported, with an assessment of its accuracy or reasonableness, should support all factual data, findings, and conclusions in reports. Except as necessary to make convincing presentations, detailed supporting data need not be included in reports. Opinions and conclusions in reports should be clearly identified as such and should be based on enough audit work to warrant them. In most cases, one example of a deficiency can support only a finding of a deviation, error, or weakness; it cannot support a broad conclusion and a related recommendation for corrective action. When appropriate, audit reports should refer to other audit reports pertaining to matters covered. For example, comments pertaining to the adequacy of the accounting system, purchasing practices, and indirect cost rates should be referenced to reports issued on these subjects.

d. Recommendations. The auditor's report should contain appropriate recommendations whenever the audit discloses that the contractor's operations can be significantly improved. The auditor should also make recommendations to effect compliance with legal or regulatory requirements when significant instances of noncompliance are noted. If the auditor cannot make appropriate recommendations, the report should state why the auditor is unable to do so and what additional work needs to be done to formulate recommendations. However, the audit report is only advisory. Because recommendations are not directives, there is no contractual requirement for the contractor to comply. Therefore, reports must be worded in a manner that will induce confidence in, and acceptance of, the audit findings and recommendations. Tactful, tempered, and factual reporting can achieve the objective of acceptance without diminishing the auditor's independence. Conversely, sharp, critical, and inflammatory expressions should be avoided because they create resentment and an atmosphere in which the auditor's conclusions may be challenged. To ensure full and fair reporting, care and diligence should be exercised so that the audit report fully recognizes contractor difficulties, other pressing needs, and corrective action taken.

e. Issues Requiring Further Study. If the scope of the audit or other factors limit the auditor's ability to inquire into certain matters which he or she believes should be studied, report such matters and the reasons why they merit further study (see GAGAS 7.46).

f. Recognition of Noteworthy Accomplishments. Information on satisfactory aspects, not just the deficient aspects, of operations examined, when significant and when warranted by the extent of the work, should be included in the auditor's report (see GAGAS 7.43). Such information is often necessary to fairly present the situation that the auditor finds and to balance the report.

g. Views of Contractor Officials. Except for audit findings in reports containing forecasted costs (refer to a listing of these reports at 10-212.2c.), one of the

most effective ways of ensuring that reports are fair, complete, and objective is through advance reviews and comments by contractor officials (see GAGAS 7.38). This produces a report that shows not only what was found and what the auditor thinks about it, but also what the contractor thinks about it and what, if anything, will be done about it. Comments on report drafts should be objectively considered and evaluated, and the report should appropriately recognize them. The auditor should drop a point or modify a position if he or she finds the contractor's argument meritorious. When a contractor promises corrective action, it should be noted in proper context but should not be accepted as justification for dropping a significant point or a related recommendation. However, if the advance comments oppose the auditor's findings or conclusions and are not, in his or her opinion, meritorious, the auditor should include the comments but should state the reasons for rejecting them.

h. Scope and Objectives. The scope of the audit should be stated in all reports. Special considerations applicable to application of agreed-upon procedures reports are discussed below in 10-103.2j. Some audits are more limited in scope than others; for example, those confined to specific functions, activities, or contracts. Such limitations should be clearly and explicitly identified. When successive audits vary in scope, the auditor should explain why particular work was or was not performed and should also define the limited nature or special aspects considered in performing the audit. The time period of the audit should be specified. The report should also include a summary of the objectives of the audit. This statement is essential to give the reader a background against which any reported findings may be considered. The contracting officer may request special coverage; this, too, should be mentioned in the report. The auditor is expected to conduct the audit (or application of agreed-upon procedures) according to generally accepted government auditing standards incorporated in the guidance in this manual. The report will state that the audit was performed according to generally accepted government auditing standards and will discuss the

requirements of those standards adapted to the type of audit being performed. The Scope paragraph will state that tests of appropriate records, internal controls, accounting principles and operations were made as necessary. The scope also includes a statement identifying the criteria used to evaluate the proposal or functional area. Scope of Audit statements vary for system audits (10-407) and for cost accounting standards audits (refer to individual subsections in 10-800.)

i. Qualifications. When acceptable auditing procedures cannot be followed, or have been limited by unavailable or inadequate records, time, or other reasons, and the limitations have a significant adverse effect on the conduct or scope of audit, the auditor should provide comments in the scope of the audit and qualify the report. When a report is qualified, the Scope of Audit paragraph always starts with the following qualifier, "Except for the qualifications discussed below, ". The nature and impact of the qualification should be described briefly. A reference to the report section where details may be found should be provided.

j. Scope of Application of Agreed-Upon Procedures. For application of agreed-upon procedures (10-1007), the scope paragraph states that the engagement was limited to procedures specified by the requestor. The traditional scope paragraph, including control risk assessment, is omitted since an audit is not being performed. A qualifications section is not used since an audit opinion is not being given. However, a Restrictions on Procedures subsection, similar to the Qualifications subsection should be included when necessary to discuss items or circumstances that have prevented completion of all of the agreed-upon procedures.

k. Omitted Information. If the auditor is prohibited from including some pertinent data in the report, he or she should describe what has been omitted and the restriction that makes the omission necessary.

10-103.3 Audit Opinion - General

a. Subject to specific reporting limitations, the report will express the auditor's

opinion and recommendations, both on the cost representations or financial statements taken as a whole or, where appropriate, on individual elements. The report will also state whether the financial data have been prepared in accordance with the Federal Acquisition Regulation (FAR), the related agency supplement, if any, and Cost Accounting Standards (CAS), if applicable and/or any other criteria used.

b. Material changes in accounting policies and procedures and their effect on the financial data are to be explained in the audit report. In addition, the report will comment on significant financial issues affecting the contractor's cost representations. Violations of legal or other regulatory requirements, including instances of noncompliance, will be explained in the audit report.

c. The contract auditor's work normally culminates in an expression of opinion on the acceptability of the contractor's cost representations or financial statements. However, cost representations or financial statements often reflect estimates, approximations, and matters of judgment or opinion, rather than absolute facts. Although other acceptable alternative accounting methods exist within the concept of generally accepted accounting principles, the governing regulations in CAS and in FAR limit the contractor's flexibility in presenting cost representations.

d. A contractor's cost representations may be prepared in accordance with its accounting system, may be based on statistical computations developed as part of the regular accounting system, or from adjunct statistical data; or the contractor may use a formula method for developing costs. The audit report should contain the auditor's opinion as to the acceptability of the methods used by the contractor. An explanation of the methods used should be provided if it is not otherwise evident.

e. The auditor should determine if any material changes have been made in the contractor's accounting practices. Material changes and the reasons for them should be identified, and their effect on the financial representations, both historical and prospective, should be explained. The auditor should also state his or her

opinion as to the propriety of the change. When applicable, CAS places some specific limitations on the extent of such changes and requires submission of price adjustment proposals as a result of changes made to previously disclosed or established cost accounting practices.

f. Events that occur after the audit may have a material effect on government contract costs. Events, such as potential contract overruns, affect government contracts directly, while other events, such as impending financial instability, affect all government work. If such events occur before issuance of the audit report, they should be disclosed in the report. If an audit report has already been issued, but the impact on government contract costs is significant, the auditor should issue a supplemental report.

g. The possibility that isolated errors of omission or commission will go undetected is always present. Therefore, the auditor cannot certify that all of the costs submitted by the contractor are correct. The auditor can only express a professional opinion as to the acceptability of the cost representations.

h. Before expressing an opinion, the auditor should have obtained and reviewed the available facts and performed, to the extent necessary, a searching and analytical review of the contractor's representations and supporting data. When necessary, the auditor should seek technical assistance from the contracting officer in those matters that fall within his or her purview, i.e., industrial engineering, production control, quality assurance, etc. The initial request should be oral, then confirmed in writing. The auditor should refer to and give effect to the technical findings and opinions of others in the audit report; when appropriate, attach a copy of the technical report to the audit report. If the auditor cannot get the necessary technical assistance before completing the audit, the opinion in the report should be qualified and should indicate the areas in which, and the extent to which, a technical evaluation is necessary. If the auditor disagrees with the technical evaluator's recommendations, he or she should attempt to reconcile the differences. If the differences remain unre-

solved, a copy of the technical report should be attached and an explanation provided in the audit report as to why the recommendations were not used (see D-302).

i. When a contractor's cost representation or financial report is sufficiently complete to permit an audit evaluation, but does not conform to requirements imposed by contracts, agreements, laws, regulations, or administrative procedures (for example, format, timeliness, or certifications), or when certificates or information required from government personnel have not been received, the audit report should explain the deficiency. The effect that the deficiency may have on the validity of the cost representation should be commented on when possible.

j. A contractor's reports and statements, both financial and operational, should contain the information necessary to form an opinion on contract financial management aspects. The responsibility for providing such information rests with the contractor. However, the auditor should comment if the data provided are insufficient to disclose any matters that may have a material effect upon government contracts.

(1) Adequate disclosure does not imply or require that every available item of information be furnished. Disclosure should, however, be fair and reasonably complete, but not so complex as to confuse or impede understanding. Information should be reduced to manageable and understandable proportions; without summarizing to such an extent that needed background or relationships are omitted or blurred.

(2) Weight should be given to materiality, which is the relative importance or relevance of an item included in or omitted from financial reports or contract cost statements. Apart from (a) the aggregate \$10,000 materiality criterion for "Unallowable Costs Subject to Penalty" specified by FAR 42.709-5(b) (see 6-609.1f.(7)) and (b) the materiality of defective price findings (see 14-120.1), there are no universal ratios or percentages that can be used as standards of materiality for financial or operational processes or transactions. Materiality should be based on judgment. Six specific

indicators of materiality that can be used individually or in combinations are:

- absolute dollar amount;
- ratio of amount of an item to an appropriate base figure;
- length of life of an asset;
- importance of the item to the accomplishment of the mission;
- importance to the maintenance of adequate controls (such as a pattern of small discrepancies); and
- characteristics of the items involved.

(3) The Cost Accounting Standards Board addressed the issue of materiality as it applies to CAS-covered contracts (FAR 9903.305). No one criterion was considered necessarily determinative. The criteria are:

- absolute dollar amount;
- proportion of the amount under consideration to contract cost;
- the relationship between a cost item and a cost objective;
- the impact on government funding;
- the cumulative impact of individually immaterial items; and
- the cost of administrative processing of the price adjustment modification.

(4) Events that occur after the audit may have a material effect on the operations of the contractor or on its financial representations. Such events should be disclosed in a supplemental audit report (see 10-214 and 10-103.3f.).

k. For application of agreed-upon procedures reports, always disclaim an opinion, since an audit is not being performed (10-1009).

10-104 Good Writing Techniques for Effective Audit Reports

a. A very important aspect of performing a quality audit is communicating the results of that audit. Good fieldwork and analysis are wasted if the audit report is not effective in communicating our audit conclusions. Our customer is interested in a clear and concise audit opinion, with supporting data that are easily understood.

b. Natural writing ability is not necessary for effective audit report writing. Effective audit report writing first requires knowledge of good writing techniques, which can be acquired through

training and practice. Each FAO's core library contains the third edition of Strunk and White's *Elements of Style*. The auditor should become familiar with this standard guide to basic rules of usage, composition and style.

c. Effective audit report writing requires selection of efficient ways of collecting the information needed for the report. The Audit Planning and Performance System (APPS) was developed so that the audit planning, documentation of the audit performance and the subsequent audit conclusions are written directly in the electronic working papers. A separate working paper package is established for each assignment. These working papers should be effectively used to draft the report. This process involves keeping the needs of the reader in mind throughout the audit so that the audit addresses all relevant issues and the auditor records the results in the format used to prepare the report.

10-104.1 Planning the Audit Report

a. Planning to write the report begins with the receipt of a request for audit and/or establishment of the assignment. Planning continues throughout the audit process, from the development of the audit program to the completion of the working papers and then the report itself. The report will not be effective unless the needs of the customer are clearly understood and addressed. If there is any confusion regarding the request or the special needs of the requestor, call the requestor immediately for clarification.

b. Early in the audit process, determine what is required for the audit report. Ensure that the audit program is properly designed so all necessary information is obtained during the course of the audit. Working paper packages should contain lead working papers that are supported by sufficient detail to support the conclusions made. A detailed summary posted to each lead sheet should be used to draft the report. This will save time since the explanatory notes to the audit report are being written at the same time the audit is being performed. The copy and paste software function easily transfers the lead sheet summaries to the draft audit report.

c. Auditor and supervisory time will be saved in the report writing and review phases when interim supervisory reviews are performed. Interim reviews are beneficial since corrections and revisions may be made timely and supporting notes verified for use in the report. This will result in a properly documented working paper package, containing all of the evidence of a well-planned audit, and working paper notes which can effectively be incorporated into the report.

d. Writing an audit report requires original writing combined with CAM suggested wording. Use the suggested paragraphs and carefully revise them to describe the audit situation. "Shell" reports are incorporated in APPS and available on the DCAA Intranet for use as an aid.

10-104.2 Organizing the Audit Report

a. The required structure for the organization of an audit report is prescribed in Chapter 10. Review the parts applicable to the audit area and tailor the audit program to include steps to gather and analyze the data necessary to comply with the guidance.

b. Section 10-200 presents specific requirements for all types of audit reports. The remaining sections of Chapter 10 discuss specific requirements for different types of audit reports. For example, section 10-300 describes price proposal audit reports and audits of parts of a proposal. Section 10-400 describes reports on audits of internal controls and operations audit reports. Keep in mind that 10-200 provides general criteria for all audits, then, where applicable, the remaining sections provide guidance tailored to specific audit areas.

c. The report can be more effective and useful to the reader if a summary of the situation is presented before going into detail. When explaining the audit position, first provide the audit conclusion, then follow with the supporting detail. The reader can then choose whether or not to read all the supporting material. This "inverted-pyramid style" of writing presents the most important point first and follows with supporting detail (see 10-210.6).

10-104.3 Drafting the Audit Report

"Shell" reports contained in the APPS are intended to incorporate all required elements into the report. However, please bear in mind that any report language example (CAM or APPS) may be modified as appropriate. Since the shell reports are for general use, the language must be tailored to reflect each audit. For reports not available in shell format, ensure that all required elements are included. The general arrangement of the report and the report contents may be found in each section in Chapter 10 at the "Report Format and Contents" subsections. The CAM suggested paragraphs, with revisions when appropriate, may be compared to the Audit Report Quality Review Sheet for CAM compliance. A very important part of the writing process is revision. If possible, prepare the draft report simultaneously as the audit is being performed. This permits ample time for reviews and revisions by the writer and others.

10-104.4 Clarity and Precision in the Audit Report

a. Review the draft report to see if it is complete and balanced. Make sure CAM guidance is followed for the type of audit report being issued. For demand assignments, check the request for audit to see if all special items have been addressed. Then determine if the report has the level of detail appropriate under the circumstances. Keep in mind that the report will be read by persons who are not auditors or accountants. Does it read well and make sense to those outside of the auditing profession? Does it read well to readers who may not be familiar with a particular contractor's practices or audit history? Will it prompt the desired action? A good audit report is clear and concise, expresses a well-founded audit opinion, meets the customer's needs, and is in accordance with the CAM guidance and GAGAS.

b. Make the report concise, but provide enough detail for it to be useful. This includes exhibits and supporting schedules -- make sure that they are adequate. Do they provide enough information for a clear and complete explanation of the audit results and recommendations?

When determining the amount of detail to include in the report, remember the report is generally written for more than one recipient or customer. Do these customers have the same background? How knowledgeable are the customers about the subject? The report should be written so that the readers will fully understand the entire report, no matter how many words are needed. A good explanatory note to an audit report, for example, would discuss the following:

- the summary of conclusions;
- the basis for the contractor's proposed or claimed amounts;
- the audit evaluation (include a description of procedures used to evaluate the area being described. If qualified, fully describe the effect of the qualification);
- the contractor's reaction (other than proposal audit reports, where judgmental items are usually not discussed with the contractor); and
- the auditor's response if the contractor disagrees with the audit results.

c. Verify the facts and check the calculations. Ensure that amounts described in the results of audit agree with exhibits and that the exhibits agree with the explanatory notes. Technical errors cause confusion for the recipient and weaken a report considerably.

d. If time permits, allow the report to "cool," preferably overnight, so that the draft may be reviewed with a critical eye. If this is not possible, perhaps a peer will agree to review it.

e. Reread the report looking for grammatical and spelling errors. Use the spell-check feature on the word processing software to help. Make sure that all names are spelled correctly. Errors in spelling and grammar also weaken a report.

10-104.5 Responsiveness to the Customer in the Audit Report

When writing the report, focus on the customer's needs. In addition to meeting GAGAS requirements, the report must be useful to the primary report recipient. To accomplish this, focus on the customer. Remember that a report accomplishes nothing unless the reader becomes better informed or is moved to action.

10-104.6 Readability of the Audit Report

a. Shorter words and sentences promote understanding. When writing a sentence, be concise; eliminate unnecessary words. A busy reader will find the report easier to read and to understand. A sentence is wordy when it includes words that add nothing to the meaning of the sentence. For example, compare the following sentences.

Wordy: It is our understanding that the contractor's estimates were prepared by using vendor quotations that are considered outdated.

Better: The contractor based its estimates on outdated vendor quotations.

The Elements of Style, available in the FAO core library, at section II, item 17, lists commonly used expressions that should be eliminated from every sentence. For example,

Wordy: the reason why is that

Concise: because

Vary the sentence length. Break long sentences into shorter ones. The average sentence length should be about 17 to 20 words.

b. Put statements in a positive form.

Negative: The contractor's internal control system of recording labor does not meet certain requirements.

Positive: The contractor's internal controls over labor recording are weak.

c. When possible, write as if speaking. Imagine talking to the reader in a professional situation. Don't try to inflate the report with impressive words. Use ordinary words that the readers easily understand. Use short words in place of long ones whenever possible. Use action words and make writing direct rather than elaborately indirect. Use pronouns if the writing calls for them. For example, "At your request, we limited our audit to" correctly uses three pronouns "your," "we," and "our."

d. Use a variety of punctuation -- beyond the period and the comma -- to control emphasis and to help avoid monotony. Use the dash only when a more common mark of punctuation seems inadequate. For example, "The contractor did not adequately support many key decisions -- such as streamlining the acquisition process and entering production without a research and development phase." The dash is a mark of

separation stronger than the comma that sets off material that results from a break in continuity or thought in a sentence. The variety of punctuation provided can help stimulate the reader's imagination, which aids in the delivery of the message.

e. Jargon, a specialized or technical language used by a select group, is difficult for persons outside of that group to understand. Avoid jargon; replace it with plain English. Consider these examples of bureaucratic jargon and the plain English replacements:

Bureaucratic Jargon:	Plain English:
afford an opportunity	let
due to the fact that	because
monetize	give a dollar value
utilize, utilization	use

Choose words and phrases carefully. Use short, simpler words and phrases for easier reading.

(1) Jargon also can be any language which clouds a sentence's meaning by hiding its main subject and verb. Compare the following sentences:

Difficult: Excess starting load costs were allocated by the contractor to the terminated portion of the contract on the basis of an unrealistically low projection of the labor costs which would have been incurred on the terminated units.

Better: Because the labor cost estimate was too low, the contractor allocated too much start-up cost to the terminated contract.

(2) Jargon also occurs when common words take on a special meaning within a profession and create confusion in the minds of those outside. For example, auditors frequently use the verb "monetize," meaning, to them, to determine a monetary value. This usage is inaccurate. "Monetize" actually means (a) to coin into money, or (b) to legalize as money. It should not appear in an audit report. Search for substitutes, such as "We have calculated the dollar value of the technical recommendations."

(3) Acronyms or abbreviations sometimes cause confusion. If an acronym is used frequently and is commonly understood by the report users, provide the complete words the first time followed by

the acronym in parentheses -- for example, total quality management (TQM). Or, reverse the order if the acronym is more familiar than the words. In such case, provide the acronym first, followed by the words it stands for in parentheses -- for example, NASA (National Aeronautics and Space Administration). When in doubt about the familiarity of the acronym or abbreviation to potential readers, don't use it. Redefine unusual acronyms periodically throughout the report. They should be redefined when first needed in each section of the report and possibly every two to three pages.

(4) Some words are used incorrectly in audit reports. "Unsupport" and "unresolve," used as verbs, are prime examples. "Unsupported" and "unresolved," when used as adjectives, are perfectly acceptable.

Correct: The contractor's tooling costs are unsupported.

Incorrect: We unsupport the tooling cost.

(5) For "plain English" words inappropriately used, refer to The Elements of Style, which may be found in the FAO core library. Part IV is devoted to words and expressions commonly misused and includes numerous examples.

10-104.7 The Visual Impact of the Audit Report

a. Visual presentation is an important part of communicating. Use headings to set off main points and "bullets" to highlight several items where one item does not have priority over the other item. For example, a bullet list is effective for listing points because:

- each point is emphasized;
 - the items are easier to see; and
 - there is more space around each point.
- Use a numbered list when the points must be taken in order or when some items are significantly more important than others.

b. Charts, graphs, and tables may be used to summarize voluminous amounts of data in a meaningful and concise manner. They add variety to the report and may easily be developed from available Agency software. Auditors are encouraged to use charts,

graphs, and tables where they result in increased clarity and understanding of complex audit findings.

c. The effective use of white space (a term from printing meaning that part of the page that does not have any ink printed on it) can make a report more inviting to the reader. If a paragraph has more than 10 to 15 typed lines, consider dividing it into two paragraphs. Group like ideas together to form separate paragraphs. Highlight extracts from regulations or the contractor's policies by separating and indenting them as a block. If paragraphs or other items are numbered or lettered, ensure that there are at least two paragraphs or items, i.e., there should be a "2" for each "1" and a "b" for each "a."

10-104.8 Active and Passive Voice

a. Using the active voice in writing can improve clarity. Knowing the difference between the active and passive voice requires understanding the grammatical structure of sentences. A complete sentence has a subject and a verb. For example, "The auditor wrote the report" is a complete sentence in the active voice. A sentence is in the active voice when the grammatical subject (the auditor) is doing the action expressed in the verb (wrote). In this sentence, the active voice sounds more natural than passive voice and is easier to understand.

b. The same statement could be expressed in the passive voice: "The report was written by the auditor." In this case, the grammatical subject (the report) has the action of the verb performed on it (was written). A sentence is in the passive voice when the subject receives the action of the verb.

c. Sometimes voice is confused with tense. Voice indicates whether the subject is doing the action (active voice) or is receiving the action (passive voice). Tense indicates time or duration. A sentence in the active voice can be in forms of the past, present, or future tenses -- "The auditor wrote the report;" or "The auditor is writing (or writes) the report;" or "The auditor will write the report." All of these examples are in the active voice but are in different tenses.

d. Bureaucratism, the language of the bureaucracy, often uses the passive voice because it is easier to avoid stating who is

doing the action. In the sentence in the passive voice "The report was written," there is no mention of who did the writing. Writing in the active voice forces the writer to state who is doing the action: "The auditor wrote the report." In this sentence, use of the active voice makes the sentence stronger and easier to visualize and understand.

e. Good technical writing often requires use of the passive voice. There is nothing wrong with using the passive voice when the emphasis is on the effect of the action, not the actor. ("Bad debts are questioned," not "The auditor questioned bad debts," or "FAR 31.205-3 mandates the questioning of bad debts.") The passive voice is appropriate when the doer of the action is understood and perhaps not important to what is being said. As a rule, use of the passive voice should be limited to situations in which the doer is:

- unknown;
- unimportant;
- deliberately de-emphasized; or
- obvious to the customer.

These situations are quite common in audit reports and other technical writing.

10-104.9 Misplaced Modifiers and Pronouns

a. A "modifier" is a word (usually an adjective or adverb), a phrase, or a clause that modifies the meaning of another word or phrase. Place modifiers in sentences so they are close to the words they define.

Misplaced: He only found two mistakes. (Because "only" can be either an adjective or an adverb, it can modify either nouns and pronouns (as an adjective) or verbs, other adverbs, and adjectives (as an adverb). As placed in this sentence, it can modify the pronoun "he" and the sentence appears to mean "He did nothing other than finding two mistakes.")

Correct: He found only two mistakes. (Here "only" modifies "found;" we don't know what else he did, but he found no more than two mistakes.)

b. A modifier makes the meaning more specific. When a modifier is too far from the word it modifies, the reader may connect the modifier to some other word. The reader

may also be confused when a modifier ambiguously appears to modify two words.

c. Too many modifiers weaken writing. Strings of words or phrases often bury the subject and confuse the reader. The following is an example of a string of words that together modify the last word: "nonrecurring cost recoupment charge internal controls." The first five words say what kind of controls there are, but it is difficult to read. An improved version is "internal controls for recoupment of nonrecurring cost." (This version suffers from "prepositional decay;" the prepositional phrase "for recoupment" is modified by the prepositional phrase "of nonrecurring cost." In technical writing, style must sometimes be sacrificed to clarity.)

d. Similarly, pronouns are often misplaced. Pronouns, similarly to acronyms, are substituted for nouns for brevity and to reduce repetitiveness. A pronoun must agree with its antecedent in person and number (third person singular pronouns must also agree in gender). The antecedent of a pronoun is usually the closest noun preceding the pronoun that agrees with it in person and number. The following sentence illustrates what can happen when too many other possible antecedents come between the intended antecedent and the pronoun: "You hold the hammer while I hold the nail, and when I nod my head, you hit it."

10-104.10 The Requestor's Perspective

a. The tone of the report should be objective, professional, and courteous. Use conversational English, which is a relaxed, professional style. Report writing can be somewhat informal in tone yet remain professional and businesslike. Keep in mind that the goal is to get a favorable reaction. Avoid using accusatory, inflammatory language -- this is likely to cause defensiveness and opposition. In presenting problem areas, emphasize improvements needed.

b. Review the draft from the customer's perspective. Is the report thoroughly responsive to the customer's request? Remember that a report accomplishes nothing unless it is useful to the requestor.

10-104.11 Final Steps

a. Before submitting the report for supervisory approval or for peer review, check again to ensure the report complies with CAM guidance. The draft report should always be cross-referenced to the working papers. This ensures that the audit conclusions are supported and are easily found. A peer reviewer should not rewrite the report in his or her own personal style, but should provide a critical review for content and for the good writing techniques such as those outlined in this section. If a peer reviewer is not available, put the report aside for a day

or two, if time allows, then reread the report. If it does not make sense when being reread, it will probably not make sense to the reader either. Another point of view during the review process can help develop a final draft needing little or no revision by the supervisor.

b. If the supervisor requires the report to be modified, ensure that the change is reflected throughout the entire report. If significant changes are made to exhibits and schedules, request the peer reviewer to check both the "carry" of numbers from schedules to text and the mathematical accuracy of the report.

10-200 Section 2 --- Audit Report Format and Contents (General)**10-201 Introduction (Reports-General)**

a. This section discusses DCAA requirements governing audit report content; details the general administrative and format requirements of audit reports; lists and defines the elements of audit reports in their order of appearance in the report; summarizes DCAA policy regarding protection of report information; and provides guidance on audit report distribution. It also explains the circumstances under which supplemental audit reports should be issued and describes the recommended format for these reports.

b. The guidance included in this section is general in nature and applies regardless of the type of audit report being prepared. Specific report preparation requirements for various types of individual audit assignments are discussed in the remaining sections of this chapter. "Shell" reports, which include standard paragraphs required by specific reports, are available on the DCAA Intranet and the APPS.

10-202 Reporting of Audit Results (Reports-General)

To satisfy government reporting standards (2-400 and 2-600), there must be a written record of the results of each audit. Normally, this requirement is satisfied by issuing an audit report. Certain situations, however, may call for preparation of a "MEMORANDUM FOR RECORD" (refer to DCAAM 5020.1, Correspondence Manual) rather than an audit report. This may be appropriate, for example, upon completion of an individual overhead account audit, which represents only one portion of a final overhead audit report to be issued later, and the individual audit does not find any audit exception, system deficiency, or economy and efficiency findings that need to be reported to contracting officers. Under no circumstances will reports be addressed "to the file" or "for the record" (See 10-206 for addressing requirements).

10-203 Report Administrative Requirements (Reports-General)**10-203.1 Paper**

Prepare reports on 8 1/2 by 11 inch paper. If wider sheets are needed for tabulations, fold or reduce them to 8 1/2 by 11 inches. The paper should be white and of a grade, weight, and substance as available through normal supply channels for laser printers and for copiers.

10-203.2 Margins

Margins should be uniform; e.g., allow 1 inch for left and right margins and at least 1 inch at the bottom of the page. There should be at least two lines between the last line of typing and the page number.

10-203.3 Typing

Computer equipment and Agency designated word processing software should be used to the extent possible to prepare all portions of the report, including exhibits and schedules.

10-203.4 Paragraphing

a. Other than the "AUDIT REPORT AUTHORIZED BY" section title, which should be bold, placed at the left margin and followed by a colon, section titles should be bold, upper case and centered in the narrative portion of the report. When a paragraph subtitle is appropriate, place it on a separate line. Paragraph subtitles should be regular type, upper case, and placed at the left margin (see Figure 10-2-2).

b. The first sentence of main paragraphs should be indented no more than one half of one inch (tab at .5") from the left margin. The subparagraphs within "SIGNIFICANT ISSUES," "QUALIFICATIONS," "EXPLANATORY NOTES," and "RESTRICTIONS" will be lettered or numbered if there are two or more; when there is an "a", there must be a "b", etc. The sequence for paragraph numbering is 1. a (1) (a).

c. Any subparagraph after a lower case letter in parentheses [(a), (b)] is discouraged. Try to use paragraph captions wherever possible to avoid this.

10-203.5 Upper Case Lettering

The audit report cover sheet (10-205) should include the heading and captions in upper case letters as shown in Figure 10-2-1. Paragraph titles and subtitles within the report should also be in upper case letters. The “FOR OFFICIAL USE ONLY” footer will also appear in bold upper case letters. Explanatory note captions may be written in upper and lower case letters and underlined.

10-203.6 Date

Express the month, day, and year of the audit report in the order named (for example, December 16, 20XX). The date can be either stamped or typed. The FAO should have a control in place to ensure that reports are dated only after they are signed.

10-203.7 Page Numbering

a. Do not number the cover sheet (letterhead page) or place a number on the next (first) page of the report. Begin numbering pages on the second page of the report with the number “2.” Consecutively number pages through the report distribution and release restrictions. Numbers should be placed at the bottom center of the page, above the “FOR OFFICIAL USE ONLY” footer. Do not offset page numbers with periods, dashes, or other punctuation. Examples of report numbering are contained in the audit report shells.

b. If DCAA assist audit reports, government technical reports, or other documents that are individually numbered are included in a report as appendixes, it is necessary to number only the first page of the document. In cases where many appendixes are included in a report, it may be convenient to preface each appendix with a blank sheet indicating the title of the appendix and page number rather than making any annotations on the particular document.

10-203.8 Numbering Audit Reports

a. The audit report number is the assignment number prefixed by the regional organization code (RORG) of the Branch Office or Resident Office. This is necessary as the Agency MIS reports are sorted at the Branch Office or Resident Office RORG level only. The Suboffice RORG does not appear on Agency MIS reports. The audit report number must be identical to the assignment number set up in the DMIS. No additional alphanumeric characters are to be added to the audit report number. The audit report number will be shown at the top left margin of each page of the report, after the audit report cover sheet. On the cover sheet, the audit report number will be centered under the Agency name at the top of the cover sheet as shown in Figure 10-2-1.

b. The FAO, at its option, may include the Suboffice RORG and/or a chronological reference number known as a “Chron. No.”, as the last item in the “REFERENCES” section of the cover sheet. The Chron. No. should not appear anywhere else in the audit report.

10-203.9 Report Assembly and Reproduction

a. Producing an “Original” and Copies. Reports should be reproduced by the most efficient and economical means that ensures a professional appearance. The “original” copy of the report must be signed by an auditor with the authority to do so (10-211).

b. Fastening. Reports will be securely fastened at the left margin. Thus, any tabulations or graphs, for example, must be positioned with their headings either at the top or at the left side of the assembled report.

10-203.10 Electronic Distribution of Reports

a. To the maximum extent possible, all written correspondence and audit reports should be transmitted electronically to requestors and customers via e-mail. DCAA e-mail to DoD components will be sent only through Defense Information Systems Agency (DISA) supported

communications channels to ".mil" addresses. NASA Headquarters Office of Procurement has also authorized its NASA Centers (generally ".nasa.gov" addresses) to request and receive DCAA audit reports electronically. Procedures for electronic communications with other non-DoD customers should be determined on a case-by-case basis after consultation with the customer and the regional information technology (IT) staff. Transmission of "For Official Use Only" material using private and commercial service providers such as AOL or CompuServe is prohibited.

b. Due to the limitations in file size that can be accommodated by e-mail software and servers, large electronic files (over 500kb) should be compressed. Electronic files can be saved and compressed in a variety of formats and software versions. Thus, it is critical to communicate with customers to determine the version and brand of software they are using. Based on customer requirements, choose the appropriate format and version that provides the best opportunity for the customer's efficient use of the audit report and any accompanying files or attachments. The regional IT staff should be consulted if problems arise while preparing files for transmission or during the electronic transmission.

c. Cover e-mail messages for audit reports should only include administrative-type information. Cover messages will provide information such as:

- (1) name of document attached,
 - (2) software used to prepare the report; e.g. Microsoft Word XP,
 - (3) comment that the audit report is marked "For Official Use Only,"
 - (4) comment regarding the use of password protection of the document to guard against modification,
 - (5) if applicable, instructions for opening the compressed file(s), and
 - (6) if applicable, whether and why an electronic report is incomplete.
- An example cover message follows:

"Attached is subject audit report [*provide file name*] which is prepared in [*specify the specific version of Microsoft Word*]. The attached report is For Official Use

Only. While it is password protected from accidental changes, it can be opened as a "read only" document without using the password. However, information within the report can be copied to a new document for analysis purposes.

The report was compressed using [*specify the software used and whether the file was saved as a self-extracting file or not*]. To extract (decompress) the report [*provide specific steps to the user on how to extract the file*].

The report is incomplete [*provide reasons why (e.g., hard copy forthcoming) the report is incomplete to the customer*].

If you have difficulty opening the audit report document or have other questions, please contact [*provide points of contact to the customer, including telephone number and e-mail address*]."

10-203.11 Citations of Legal Opinions

Audit guidance is based on generally accepted accounting principles, applicable government regulations, and rulings of Boards of Contract Appeals and Federal courts. Often the authoritative source of the guidance (e.g., a board or court case) is cited in CAM and/or specific audit guidance provided by Headquarters in support of the recommended audit conclusion. The guidance stated in CAM and specific audit guidance, including relevant legal citations, should be employed in the audit and explained in the audit report to the extent necessary to support the audit conclusions. When the auditor believes it is necessary to include in the audit report a legal citation not discussed in CAM or Headquarters guidance, the citation must be formally coordinated, through the region, with Headquarters, Policy and Plans Directorate. The Headquarters division responsible for the audit issue will coordinate with our legal advisors and the FAO to ensure that the citation is relevant and properly applied.

10-203.12 Insignificant Amounts/ Elimination of Cents

a. Only significant amounts of questioned costs should be displayed in audit reports. The CAS materiality criteria in 48 CFR 9903.305(a) to (f) should be considered in making this determination. These criteria are: absolute dollar amount; ratio of the amount of an item to an appropriate base figure; relationship between a cost item and cost objective; the impact on government funding; the cumulative impact of individually immaterial items; and the cost of administrative processing of the audit exception.

b. Cents should not be included in summary report paragraphs, exhibits and schedules. However, they can be used in certain explanatory notes and supporting schedules, such as those relating to direct labor rates or material unit prices.

10-203.13 Protection of Report Information

All DCAA audit reports not containing classified information are "FOR OFFICIAL USE ONLY" and will be marked "FOR OFFICIAL USE ONLY" centered at the bottom of each page of the report. When pages are numbered, (beginning with page number "2") the number is positioned above the "FOR OFFICIAL USE ONLY" footer. Reports containing classified information will be prepared, classified, marked, and protected in accordance with DCAAM 5205.1, "Information Security Program." To the extent possible, limit classified material included in the report, because audit reports must be classified at the highest security classification contained therein. Also see 10-205.2 if the report pertains to a classified subject.

10.203.14 Report Terminology

a. The report terminology used in this chapter reflects Statement on Standards for Attestation Engagements (SSAE) 10, issued January 2001. However, SSAE 10 never uses the term "audit" or "auditor." Instead it refers to three types of "evaluations" (examination, review, and application of agreed-upon procedures) and "practitioners." DCAA is covered by Generally Accepted

Government Auditing Standards (GAGAS), which incorporates the SSAE for financial-related audits (GAGAS chapters 4 and 5). However, GAGAS continues to refer to "audits" and "auditors." All of the work that DCAA performs, the related fieldwork, and the resulting reports are therefore "audits." The term "audit" will continue to be used as a generic term to describe all of DCAA's work. The specific types of audits DCAA auditors perform are examinations, reviews and applications of agreed-upon procedures, and when referring to a specific type of audit, DCAA will use this terminology. In addition, an examination (highest level of assurance) will continue to use the word "audit" in report captions. In general, the work that DCAA auditors perform has not changed; but the report terminology differs under GAGAS and SSAE. Operations audits are an exception because they are performance audits under GAGAS chapters 6 and 7, and are not subject to the SSAE. Refer to 10-403.

b. The difference between an examination, a review and an application of agreed-upon procedures, simply stated, is the level of assurance. For details, refer to Chapter 2. The preferred terms are contained in the Subject, Scope and Results paragraphs in each section in Chapter 10. If the audit is an examination, the report caption is "Subject of Audit," but the related report narrative will state "we examined." Similarly, if the audit is either a review or an application of agreed-upon procedures, the report captions are "Subject of Review" and "Subject of Application of Agreed-Up On Procedures," respectively. The related report narratives will state "we reviewed" or "we applied agreed-upon procedures."

c. Most of the audits DCAA auditors perform are examinations that require a high level of assurance. If the assignment is reduced to a moderate level of assurance, a review may be performed. Attestation standards provide that audits of internal control (10-400) and audits of compliance with laws and regulations (10-600 and 10-800) may not be performed as reviews. However, any assignment may be performed as an application of agreed-upon procedures when the procedures to be performed have been specified by the requestor. Refer to 10-1000

for requirements. Currently, specific guidance has been provided for only one type of review, an incurred cost desk review (10-506).

10-203.15 Spreadsheets

a. An assessment should be made in each case if the contents of a detailed Excel spreadsheet should be useful to the report user. Generally Excel spreadsheets should not be embedded in the audit report. If the contents of a spreadsheet are to be included in a report, they should be pasted into the report as a table as opposed to a spreadsheet. This method of providing information reduces the chance of accidental change, provides only the data the auditor intended to include in the report, and keeps the audit report file size at a minimum to facilitate electronic transmission.

b. In many instances, audit report recipients find the auditor's spreadsheets useful in performing negotiation scenarios, preparing business clearances, etc. Where reports contain tables generated from spreadsheets that may be useful to the recipient, an offer to provide the spreadsheets should be included in the Results of Audit. Where spreadsheet usage was significant, the auditor may also contact the requestor in advance to determine if the requestor would like the spreadsheets to be provided outside the audit report.

10-204 Report Format (Reports-General)

Major examination or review report components are listed below in the sequence in which they generally appear. They are discussed in detail in the referenced paragraphs (see 10-1000 for the components of a report on an application of agreed-upon procedures). Those components highlighted with an asterisk should appear in every DCAA audit report regardless of type to satisfy minimum professional standards. Other elements may or may not be included in a particular report depending on the type of audit performed or other circumstances. For example, "Qualifications" is not identified with an asterisk but becomes a mandatory report requirement if existing conditions require its use. Elements pertaining only to

certain report types are indicated. Refer to the remaining sections of Chapter 10 for additional guidance on audit report preparation for specific types of audit assignments. Requirements for reports on applications of agreed-upon procedures are covered in 10-1000.

[Audit] Report Cover Sheet (10-205)*

Addressee (10-206)*

Subject (10-207)*

Reference (10-208)

Contents (10-209)*

Report Narrative (10-210)*

Subject of Audit (10-210.1)*

Executive Summary (10-210.2)

Scope of Audit (10-210.3)*

Qualifications (10-210.4)

Statement of Changes (CAS reports only - see 10-803b.)**

Results of Audit (10-210.5)*

Opinion

Exhibits and Schedules (10-210.5b.)

Unsatisfactory Conditions and/or Other Audit Recommendations (4-800)

Additional Remarks (10-210.5e.)

Statement of Condition and Recommendations (see 10-409 and 10-803b.)**

Cost Impact only - see 10-803b.)**

Contractor Organization and Systems (10-210.7)

Status of Corrective Action Taken on Prior Recommendations (e.g., System Reports)

DCAA Personnel and Report Authorization (10-211)*

Audit Report Distribution and Restrictions (10-212)*

Appendixes (10-213)

*Required in every report regardless of type. Note the modified report language for reviews (10-506) and application of agreed-upon procedures (10-1000).

**Replaces Exhibits and Schedules for operations, internal control, or CAS reports.

10-205 Cover Sheets

10-205.1 General

a. An Agency letterhead cover sheet bearing the DoD and DCAA seals is required for the original of every report, in-

cluding reports transmitted electronically. The general format is shown in Figure 10-2-1. Audit report restrictions relative to (1) Freedom of Information Act requests, (2) confidentiality of contractor information in the report, (3) restriction on release of the report outside the Department of Defense, and (4) release of subcontract audit reports to the higher-tier contractor, are referenced on the cover sheet ("REPORT RELEASE RESTRICTIONS" and "CONTENTS") and provided in detail immediately following the signature page of the report. See 10-212, Report Distribution and Restrictions.

b. Include the report heading (Agency name and report number), date, captions and descriptive information relative to the audit on the cover sheet as presented in Figure 10-2-1. The report date must be the date the report is signed and forwarded to the requestor or other addressee; it should not be incorporated as a field date, since a permanent record of the issue date is required. The FAO may also include its e-mail address in the "PREPARED BY" section as shown in Figure 10-2-1.

10-205.2 Cover Sheets for Reports on Classified Subjects

a. If the report contains a security classification (see 10-203.13), the classification marking must replace "For Official Use Only" on the report cover. This should be done by deleting "FOR OFFICIAL USE ONLY" and inserting the appropriate security classification on both the top and bottom of the audit report cover. If a stamp for the appropriate classification is not available, classification markings should be made in letters conspicuously larger than the size of the print of the report.

b. If an audit report pertains to a proposal or a contract that is classified or includes classified elements, and the auditor is unable to determine the appropriate security classification of the report, a special "warning" label (DCAA label 5) must be affixed (see DCAAM 5205.1, DCAA Information Security Program Manual, Section 1-400.b). The label is placed above, but not covering, the "FOR OFFICIAL USE ONLY" legend on the audit report cover, and the report must be

sent via registered mail. Contact the regional security officer for instructions prior to release of the report. Regional offices should consult with the Headquarters security officer if they have questions on this procedure.

10-206 Addressees (Reports-General)

10-206.1 Prime Contract Report Addressees

a. It is DCAA policy that audit reports at the prime contract level be addressed to a contracting officer unless it is clear that another acquisition official will be responsible for resolving the audit findings and recommendations. For example, reports on price proposals (9-100) would be addressed to the procuring contracting officer (PCO) unless a plant representative/administrative contracting officer (ACO) has been delegated procurement authority to execute the particular contract action. This policy results in audit findings being directed to the individuals responsible for resolutions and facilitates timely contracting officer action.

b. Even if the audit report does not contain findings requiring resolution, the report addressee should normally be the cognizant contracting officer. Under no circumstances will reports be addressed "To the File" or "For the Record."

c. A number of non-DoD agencies make requests for audits through their Office of Inspector General, which may be responsible for arranging audits for many procurement offices. The assigned number or other assignment identifier contained in the audit requests is their primary means of identifying these assignments. To help these offices control their assignments and expedite transmittal of reports to responsible officials, non-DoD agency assignment numbers, or other assignment identifiers contained in requests for audit will be included on the cover sheet reference line and within the first paragraph of the "Subject of Audit" section for reports issued to these agencies. Other non-DoD reporting requirements appear in 15-100.

d. Audit reports in support of team system evaluations led by contract administration organizations, such as the

Contractor Purchasing System Review (5-1302) or the Contractor Insurance/Pension Review (5-1303), should be addressed to the designated team captain. Reports on should-cost team reviews (9-1300) will be addressed to the PCO. Audit reports on Earned Value Management System (EVMS) initial compliance audits (11-202.3) will be addressed to the review director; and reports on EVMS surveillance audits (11-202.5) will be addressed to the lead acquisition activity through the principal cognizant ACO (see 10-206.4). Reports required to support an investigation will be addressed to the requestor.

10-206.2 Subcontract and Intracompany Report Addressees

Most FAO audit reports on intracompany and subcontract matters will also be addressed in accordance with 10-206.1. In certain audit areas, however, such as postaward audits of cost or pricing data (10-600), procurement needs may be better served if the auditor's report from the other company segment or subcontractor level is addressed to the contract auditor at the prime contract level. The recipient auditor will then incorporate the findings and recommendations into a single audit report for action by the responsible contracting officer. Appropriate variations in addressing and distribution of intracompany and subcontract reports will be covered in later sections of this chapter (see 10-303.2, 10-605.2, and 10-708b.).

10-206.3 Form of Address

As a matter of form, audit reports are not normally addressed to an individual by name but to the title of the position. However, if the report is for an office with several contracting officers, the address block should identify the individual in some appropriate manner. This may be done by placing the ACO/PCO's room number, "desk code," "mail stop," or name in parentheses following the contracting officer designation. For example, report addresses may begin: "Procuring Contracting Officer (Code 03D-1)" or "Administrative Contracting Officer (Ms. Mary Z. Brown)."

10-206.4 "THRU" Addressing

When required to route the original report through an intermediate action office other than the addressee's office, use "THRU" addressing. For example, if a report on an audit of a price proposal is addressed to a PCO (other than the plant representative/ACO acting as a PCO) but is to be routed thru the ACO, the "PREPARED FOR" element will be followed by a "THRU" element, as illustrated in Figure 10-2-1. This is generally the case when the ACO is also participating in the field pricing audit of a contractor's submission by providing a price analysis or technical evaluation.

10-206.5 Attention Lines

It is acceptable to use a separate "Attention" line, which may be placed either under the addressee's name or under the office name of the "PREPARED FOR" and/or "THRU" address block when the addressee has requested the FAO to route the report directly to a particular organizational section or individual within the addressee's office. Do not use an "Attention" line to identify the contracting officer to whom the report is addressed (see 10-206.3).

10-207 Subject Line (Reports-General)

The "SUBJECT" line shown on the report cover sheet should provide a brief description of the audit performed (e.g., Report on Audit of Proposal for Initial Pricing, Report on Audit of Labor Costs, Report on Postaward Audit of Cost or Pricing Data, etc.). Refer to Figure 10-2-1 for an example of the "SUBJECT" line.

10-208 References Section (Reports-General)

a. A "REFERENCES" section should be included immediately after the "SUBJECT" line on the cover sheet. This "REFERENCES" line will identify the audit request, if applicable, including specific reference to any case numbers or assignment identifiers contained in the audit request. This reference line should also be used in subcontract assist

audit reports to assist the prime contract auditor in identifying the contract to which the assist audit relates. If a Suboffice RORG or Chron. No. is referenced, it should be the last item which appears in "REFERENCES." If this is a self initiated assignment, the "REFERENCES" section is not mandatory.

b. The auditor should include both the PCO and the ACO case numbers or identifiers if known. In many instances, especially when non-DoD inspector general offices arrange audits for their agencies, the assignment identifier included in the request is the primary means of tracking these assignments. In addition, include a line for "Relevant Dates." This line will indicate what page number the reader should refer to for information used to compute elapsed days, as well as requested due dates and extensions. This information should be described in the "DCAA Personnel and Report Authorization" section of the report.

10-209 Table of Contents (Reports-General)

a. The table of contents will be located on the cover sheet for all audit reports. The "CONTENTS" section should be simple and uncluttered, as illustrated in Figure 10-2-1. Exhibits and schedules should not be listed individually in the "CONTENTS." Instead, the reader will be able to find references to exhibits and schedules by reading listed sections of the report, such as "Results of Audit."

b. Appendixes. If there is only one appendix to the report, show the title and page number in the "CONTENTS." If there are multiple appendixes, use the term "Appendixes" in the "CONTENTS" and show the page number for the first appendix in lieu of listing each appendix.

c. Internal Hyperlinks. The DCAA APPS provides links from the table of contents to the applicable sections of the report. The Exhibit may be hyperlinked to the explanatory notes if desired. All other hyperlinks in final audit reports (such as those to working papers) must be removed.

10-210 Report Narrative (Reports-General)

All reports must have a narrative body that includes comments on the subject and scope of the audit, any limitations on the scope of audit performed (if applicable), and a detailed description of the audit results. The contents of each of the report paragraphs are discussed below. The remaining sections of this chapter expand on the content of each of the narrative paragraphs as they apply to particular types of reports, such as price proposals, cost accounting standards, postawards, etc.

10-210.1 Subject of Audit

a. If the audit is financial related, begin this section by identifying the contractor assertion on which the report expresses a conclusion and the nature of the engagement (examination, review, application of agreed-upon procedures). Ordinarily the assertion will be a contractor submission; however, when internal controls or CAS compliance is audited, the assertion is implicit (see 10-800 and 10-400). The purpose and objectives of a financial related audit always include expressing a conclusion on the reliability of the contractor's assertion. If the evaluation was a systems audit, identify the subject matter and fully describe the purpose of the audit.

b. Depending on the nature of the audit, information should be included regarding the time period covered by the audit. This information is mandatory for audits of CAS compliance or internal controls, and may be included on other audits, along with such data as date, dollar value, and type of contractor submission, period of performance of the proposed effort, and contract data such as contract type and incentive provisions. Audit reports on price proposals should also include statements about additional cost or pricing data submissions.

(1) An example of a statement that could be included in a report on a price proposal examination follows:

"As you requested on [insert date of request], we examined [insert contrac-

tor's name] \$ [insert total proposed price including profit or fee, if any] proposal for [insert description of service or product to be provided] to determine if the proposed costs are acceptable as a basis to negotiate a fair and reasonable contract price. [Insert contractor's name] submitted the [insert type of proposal], dated [insert date of proposal] in response to [insert RFP or solicitation number]. The contractor proposed a performance period of [insert inclusive dates of contract performance]. We also examined the additional supporting cost or pricing data specifically identified in the contractor's letter(s) dated [insert dates of contractor supplemental submissions of cost or pricing data].

The proposal and related cost or pricing data are the responsibility of the contractor. Our responsibility is to express an opinion on the proposal based on our examination."

(2) If the auditor is disclaiming an opinion in an examination report due to an inability to obtain sufficient competent evidential matter because of a scope limitation, the Subject of Audit section's standard paragraph should be changed. The first sentence should state "we were requested to examine" (if a request was received) or "we attempted to examine" (if self-initiated) rather than "we examined" since, because of the scope limitation, the auditor was not able to perform an examination in accordance with generally accepted government auditing standards. In addition, the last sentence "Our responsibility is to express an opinion on the proposal based on our examination" should be deleted due to the scope limitation. The following is an example of a Subject of Audit paragraph to be used in a report with a disclaimer of opinion for which an audit request was received:

"We were requested on [insert date of request], to examine [insert contractor's name] \$ [insert total proposed price including profit or fee, if any] proposal for [insert description of service or product to be provided]

to determine if the proposed costs are acceptable as a basis to negotiate a fair and reasonable contract price. [Insert contractor's name] submitted the [insert type of proposal], dated [insert date of proposal] in response to [insert RFP or solicitation number]. The contractor proposed a performance period of [insert inclusive dates of contract performance]. We were also requested to examine the additional supporting cost or pricing data specifically identified in the contractor's letter(s) dated [insert dates of contractor supplemental submissions of cost or pricing data]. The proposal and related cost or pricing data are the responsibility of the contractor."

(3) The SSAE treats the word "opinion" as reserved to examinations. AT 1.68 states, "When attestation risk has been restricted only to a moderate level, (a review) the conclusion should be expressed in the form of negative assurance." The pro forma review reports appearing at AT chapter 1, appendix B exclude the "responsibility" sentence. Since DCAA retains responsibility for the content of its reports, a statement that might be included in a report on a review (see 2-103c(2)), such as a desk review of a low-risk indirect cost submission (see 6-104.5) could read as follows:

"We reviewed the XYZ Company's February 15, 20XX certified final indirect cost proposal for reimbursement of FY 20XX costs. The purpose of the review was to establish indirect cost rates for the period. The proposed rates apply primarily to the flexibly-priced contracts listed in Exhibit __, page __. A copy of XYZ's Certificate of Final Indirect Costs, dated January 2, 20XX, is included as Appendix 1 to the report (see page __).

The proposal is the responsibility of the contractor. Our responsibility is to report our conclusions on the proposal based on our review."

(4) If the evaluation is financial related and was limited to specific functions or ac-

tivities, if particular work was or was not performed, or if special aspects were considered in performing the evaluation, perhaps at the request of the contracting officer, the Subject paragraph should also include appropriate special comments. For example:

(a) "At your request we limited our evaluation to the application of direct labor and indirect expense rates."

(b) "At your request, we limited our evaluation to a determination that the contractor's proposed labor rates comply with wage board determined prevailing rates for the locality."

(5) An example of a statement that might be included in a report on an operations audit follows:

"We evaluated the contractor's plant maintenance function which is responsible for the maintenance and repair of equipment and buildings at the Boston facility. The audit was performed to evaluate the effectiveness of the contractor's policies and practices in assuring that maintenance tasks are carried out in a timely, efficient, and economical manner. The audit was conducted from November 20XX through February 20XX and covered contractor operations for the fiscal year ended December 31, 20XX."

Note that, unlike examples (1) and (4), an operations audit is not a financial related audit. It is a performance audit subject to the requirements of GAGAS chapters 6 and 7.

10-210.2 Executive Summary

This section is intended to give the reader a brief overview of the audit findings. It should briefly describe the audit recommendations and the significant issues supporting the opinion. The Executive Summary should rarely exceed one page for any audit. This section can be omitted in reports where the Results of Audit sufficiently summarizes the audit findings. Examples where the Executive Summary may be omitted include contract audit closing statements

and reports with no audit findings. An example of an Executive Summary is shown in Figure 10-2-2.

10-210.3 Scope of Audit

a. Introduce the scope of audit paragraph with the following statement, modified as shown where appropriate. An example of a scope statement to be used in an examination follows:

"Except for the qualifications discussed below, *[omit if the report is not rendering a qualified opinion and there is no "Qualifications" section within the "Scope" paragraph]*, we conducted our examination in accordance with generally accepted government auditing standards. Those standards require that we plan and perform the examination to obtain reasonable assurance about whether the data and records examined are free of material misstatement. An examination includes:

- evaluating the contractor's internal controls, assessing control risk and determining the extent of audit testing needed based on the control risk assessment;
- examining, on a test basis, evidence supporting the amounts and disclosures in the data and records evaluated;
- assessing the accounting principles used and significant estimates made by the contractor;
- evaluating the overall data and records presentation; and
- determining the need for technical specialist assistance *[and quantifying the results of a government technical evaluation]*."

b. If the auditor is disclaiming an opinion in a report due to an inability to obtain sufficient competent evidential matter because of a scope limitation, the title of the Scope of Audit section should be changed to Scope Restrictions. In addition, the section must omit the statement "we conducted our examination in accordance with generally accepted government auditing standards. Those standards require

that...” Instead, the auditor should briefly state all the substantive reasons for the disclaimer in the Scope Restrictions section. If necessary, details regarding the reasons for the disclaimer may be included in an appendix. In this case, the Scope Restrictions section should properly reference the appendix. The auditor should not state here that the scope of the examination was not sufficient to warrant the expression of an opinion. That statement is more properly included in the actual disclaimer paragraph. The auditor should not identify the procedures that were performed nor include the paragraph describing the characteristics of an examination; to do so may tend to overshadow the disclaimer. The auditor should also disclose any other reservations he or she has regarding presentation in accordance with government regulations. The following is an example of a Scope Restrictions paragraph with a scope limitation imposed by the requestor resulting in a report with a disclaimer of opinion:

“Due to procurement-imposed time constraints, we were not able to obtain sufficient competent evidential matter on which to base an opinion on the (*subject matter, e.g., proposal as a whole or the parts of a proposal to be evaluated*). The time that was provided for performance of the audit did not allow us to apply auditing procedures to satisfy ourselves as to the acceptability of the contractor’s (*subject matter*).”

The following is an example of a “Scope Restrictions” paragraph with scope limitations due to uncertainties resulting in a financial capability report with a disclaimer of opinion:

“There are significant uncertainties related to the contractor’s July 15, 20XX filing of a voluntary petition for reorganization under Chapter 11 of the United States Bankruptcy Code. These uncertainties include, but are not limited to, the future actions of the Official Committee of Unsecured Creditors, the outcome of potential bidders for the contractor’s

assets, the resolution of ongoing investigations and the Bankruptcy Court’s own actions relating to its approval of the disclosure statement and confirmation of the plan of reorganization. The significance of the uncertainties precludes us from expressing an opinion on whether the contractor has adequate financial resources to perform government contracts in the current and near-term (up to a year).”

c. The scope paragraph of a review should include the following statements, modified or expanded as appropriate:

“Based on an initial assessment of low risk, we performed a limited review sufficient to confirm that there is no readily available information that would warrant a comprehensive examination. We conducted our review in accordance with generally accepted government auditing standards. A review is substantially less in scope than an examination, the objective of which is the expression of an opinion on [*subject matter*]. Accordingly, we do not express an opinion.”

(See 10-506.2b. for an example of the scope paragraph of a review; see 10-1007 for the format of the scope paragraph of an application of agreed-upon procedures report.)

d. The next scope paragraph should identify the established or stated criteria used to evaluate the proposal, submission, or system. For example, reports on audits of revised disclosure statements will state that the requirements of FAR and the applicable cost accounting standards were used as criteria in ascertaining the adequacy and compliance of the contractor’s revision. Reports on postaward audits may indicate that the criteria used to evaluate the cost or pricing data were DoD’s implementation of the law contained in FAR Subpart 15.4 and pertinent provisions of the contract. In a system report, summarize the areas that were evaluated. The following statement may be used, modified for DFARS and CAS applicability, as appropriate:

“We evaluated the *[indicate proposed costs, type of submission, or system reviewed]* using the applicable requirements contained in the:

- Federal Acquisition Regulation (FAR);
- Defense FAR Supplement (DFARS) *[for non-DoD agencies, identify specific agency supplement - see 9-102.2 and 15-102.3];* and
- Cost Accounting Standards (CAS).”

e. The scope statement should be modified depending on contractor CAS coverage. The following type statement should be included when the small business exemption applies:

“The contractor claims exemption under 48 CFR 9903.201-1(b)(3) from the practices required by the Cost Accounting Standards Board rules and regulations because it considers itself a small business concern.”

f. The last paragraph of the scope statement should provide information on how the contractor’s internal control systems affected the scope of audit. However, see 10-400 when reporting on system audits. In addition, provide a statement, which informs the reader that the audit provides a reasonable basis for the audit opinion, e.g. “We believe that our examination provides a reasonable basis for our opinion.”

(1) Summarize those accounting and management (business) systems that provide for compliance with laws and regulations for the audit area being evaluated. Include information such as:

- Opinion on the system (e.g., adequate, inadequate in part, or inadequate).
- Summary of outstanding deficiencies affecting the audit scope.
- Impact of the assessment of control risk on the audit scope.

As appropriate, refer to the Contractor Organization and Systems section for additional information on the systems. An example of this paragraph follows:

“The contractor has estimating policies and procedures for preparing and

submitting proposals and related cost or pricing data in accordance with applicable laws and regulations. We currently consider the estimating system to be inadequate in part. The contractor does not provide cost analysis on subcontractor price proposals to the government prior to agreement on contract price. Our audit scope reflects our assessment of control risk and includes expanded testing of proposed subcontract costs to provide a reasonable basis for our opinion.”

(2) At smaller contractors that do not have independent checks of compliance with policies and procedures (i.e., internal controls) or where it is not beneficial to evaluate the internal controls to serve as a basis for reducing control risk (and related audit scope), the scope of audit should summarize this information. An example of this type of paragraph follows:

“The contractor is a small business with limited resources to be applied to compliance procedures and testing. The scope of our examination reflects this assessment of control risk and includes those tests of compliance with applicable laws and regulations that we believe provide a reasonable basis for our opinion.”

g. See 10-305.3 for recommended scope paragraphs for reports on parts of a proposal. See 10-1007 for scope paragraphs for application of agreed-upon procedures reports.

h. If a government technical evaluation was performed in conjunction with the audit, the auditor will normally incorporate the technical report recommendations into the audit conclusions.

10-210.4 Qualifications

a. The purpose of this subheading within the scope of audit section is to disclose any circumstances which necessitate a qualified opinion. Circumstances having a significant effect on the conduct or scope of the audit should be clearly identified if the conditions result in a qualified opinion in relation to the

stated purpose and scope of the audit. In such case, both the “scope” and “results” paragraphs should specifically refer to this paragraph.

b. A qualified opinion states that, *except for* the effects of the matter to which the qualification relates, the subject matter of the assertion is in compliance with the established criteria (e.g., FAR/DFARS). A qualified opinion is expressed when:

(1) there is a lack of sufficient competent evidential matter or there are restrictions in the scope of the examination that have led the auditor to conclude that he or she cannot express an unqualified opinion and the auditor has concluded not to disclaim an opinion; and/or

(2) the auditor believes, on the basis of the audit, that the subject matter under audit contains a departure from the established criteria, the effect of which is material, and the auditor has concluded not to express an adverse opinion.

c. Restrictions on the scope of audit whether imposed by the requestor, the contractor, or by circumstances may require the auditor to qualify or disclaim an opinion. The decision to qualify or disclaim an opinion because of a scope limitation depends on an assessment of the importance of the omitted procedure(s) to the auditor’s ability to form an opinion on the subject matter under audit. This assessment will be affected by the nature and magnitude of the potential effects of the procedures being considered and by their significance to the subject matter under audit. When restrictions that significantly limit the scope of the audit are imposed by the contractor or the requestor, ordinarily the auditor should disclaim an opinion (see 10-210.5d). However, scope limitations due to contractors’ failure to make all pertinent records available to the auditor when the records pertain to the representations, claims, or proposals under audit would lead to reports that contain qualified or adverse opinions (see 1-504.1c. and 1-504.6).

d. The Qualifications paragraph should include only circumstances that result in a qualified opinion (see also 10-304.4). Examples of items that may be presented in this paragraph include, but are not limited to qualifications which arise from:

- contractor deficiencies, such as lack of access to or inadequate contractor records and systems;
- external impediments such as time limitations on the scope of audit, or nonreceipt of a required government report of technical evaluation or assist audit report; or
- contractor failure to comply with formal regulatory requirements, such as FAR and CAS noncompliances where cost impacts could not be reasonably determined.

e. The nature and potential impact of each circumstance and any steps taken by the auditor to overcome or mitigate the problem should be briefly stated. Also explain further action the auditor plans to take after report issuance, if applicable. Keep this paragraph brief and include a reference to the report section and page number that contains a detailed discussion of the item involved.

f. If a required government technical report is not received, indicate the reason for nonreceipt and a brief comment on the follow-up action taken to obtain the report from the organization involved. State the specific areas in which technical review is required to conclude the audit. Also recommend that the auditor be given an opportunity to review the results of the technical evaluation, determine its impact on the scope of audit and its overall conclusions, and provide a supplemental report incorporating such evaluation.

g. If the auditor receives a technical report but does not agree with its recommendations, he or she will attempt to reconcile any disagreements with the specialist who prepared the report and/or with the specialist’s supervisor. If necessary, assistance to resolve the differences will be solicited from the contracting officer. If the auditor is unable to resolve the differences, he or she should not utilize the technical report in developing the audit opinion or in determining the amount of the questioned costs. In such cases, however, the technical report will be attached to the audit report as an appendix, and the report will include an explanation of the reason the auditor did not rely on the recommendations included in the technical report. The circumstances should be ade-

quately described and the related audit conclusion appropriately qualified.

h. Auditors should be aware that FAR 15.404-2(d) requires that contracting officers be notified in writing when cost or pricing data provided are so deficient as to preclude a satisfactory evaluation or when we encounter denial of access to data or records essential to performance of a satisfactory evaluation. Written confirmation should be accomplished early on in the evaluation and include a description of the deficient or denied data or records; explanation why the denied data or records are needed; explanation of documentation or contractor action needed to correct deficient cost or pricing data; the amount of proposed cost considered unsupported because of the deficient data or the questioned costs resulting from denial of access to records; and the action taken by DCAA to obtain adequate cost or pricing data.

i. If the auditor encounters scope limitations and FAR/CAS deficiencies resulting in the subject matter of an assertion not being presented in all material respects in accordance with the established criteria (adverse opinion), the limitations should be discussed in the Scope of Audit section; however, they should not be referred to as "qualifications." The "except for" language should not be used when an adverse or disclaimer of opinion is rendered.

j. Where the auditor has assessed control risk at maximum; does not perform work sufficient to reduce audit risk to an acceptable level; and the data relied on during an audit is highly dependent on computerized information systems (see 5-111.1d), qualify the report, as exemplified below:

"To achieve the planned audit objectives [or, planned objectives for the ____ audit], we relied extensively on information processed through the contractor's computerized systems [or, name specific system(s)]. We did not perform sufficient audit procedures to determine with reasonable assurance the reliability of the computer-processed information. Therefore, our audit results [pertaining to ____] are qualified to the extent that they could

be significantly impacted by the performance of such procedures."

10-210.5 Results of Audit

a. Depending upon the type of the evaluation, this section should provide the complete details regarding the auditor's opinion (refer to 10-210.4 for a qualified opinion), results of audit, or findings of procedures, conclusions, recommendations, and additional comments including the contractor's reaction to the report findings.

b. The Results section should begin with the phrase, "In our opinion. . ." if an examination was performed. Do not use the term "opinion" in referring to the results of a review; instead, begin this section with the phrase, "Based on our review. . ." This section should contain exhibits and supporting schedules necessary for a clear and complete presentation of the evaluation results and recommendations. The words "exhibit" and "schedule" should be written entirely in upper case letters when they are used as titles. See 10-210.6 for a discussion of explanatory notes.

c. In audits of proposed or historical cost, the Results of Audit section should begin with a single tabulation that quantifies the audit findings. If further quantification is necessary, designate principal tabulations "exhibits" and identify them by capital letters in consecutive order; e.g., EXHIBIT A, EXHIBIT B, etc. Additional tabulations needed to explain any of the items in the principal exhibits will be designated "schedules." The content of the exhibits and schedules will vary depending on the type of audit report being prepared. Review the appropriate section of this chapter to identify any specific requirements for the type of audit report you are preparing.

d. Disclaimer of Opinion. A disclaimer of opinion states that the auditor does not express an opinion on the subject matter under audit. A disclaimer is appropriate when the auditor has not performed an audit sufficient in scope to enable him or her to form an opinion on whether the subject matter is in accordance with the stated criteria. See 10-210.4 for factors to consider in deciding whether to qualify or dis-

claim the audit report opinion. When the auditor is disclaiming an opinion in an examination report, the first paragraph of the standard Results of Audit section should be modified as follows:

“Due to (*state limitations in scope*) discussed in the Scope Restrictions’ section, the scope of our work was not sufficient to enable us to express, and we do not express, an opinion on whether the [*identify the subject matter*] is in all material respects, based on [*identify criteria*] as discussed with [*the contracting officer or representative*] by [*auditor*] of our office on [*date*] and as confirmed in our [*memorandum/letter*] to you dated [*date*].”

An example of a disclaimer of opinion on a pricing proposal is as follows:

“Due to the procurement-imposed time constraints discussed in the Scope Restrictions section, the scope of our work was not sufficient to enable us to express, and we do not express an opinion on whether the contractor’s proposal is in all material respects, based on [*identify criteria, such as FAR, DFARS, other Agency supplement regulations, and CAS*] and, therefore, acceptable as a basis for negotiation of a fair and reasonable price as discussed with [*the contracting officer or representative*] by [*auditor*] of our office on November 12, 20XX and as confirmed in our memorandum to you dated November 15, 20XX.”

e. Additional Remarks. Conclude the Results section of the report narrative with the following comments, as appropriate:

(1) Exit Conference

(a) In reports on all evaluations, state the date held and the name and title of the contractor’s designated representative with whom the exit conference was held (see 4-304). If an exit conference was not held, the report should explain the circumstances.

(b) Summarize in this section the contractor’s reaction to factual differences, the major areas of difference likely to be pursued at negotiations, and any other comments relevant to resolution of the findings. Detailed comments on the contractor’s reaction to the report findings will be included in the explanatory notes.

(c) If the engagement is an evaluation other than those listed in 10-212.2c., include the following statement:

“We provided a draft copy of [*the Report*] or [*the Results of Audit*] or [*the Statement of Condition and Recommendation*] and/or [*Other (describe)*] to the contractor’s representative at the exit conference.”

(d) When a contractor provides a formal, written response, it should be referenced within the Results of Audit section and included as an appendix to the audit report. Include the following statement:

“The complete text of the contractor’s response appears as Appendix [X].”

(2) Other Additional Remarks

(a) If information in the report was provided to the contracting officer in advance by telephone, make a confirming statement here identifying the information.

(b) Mention any subsequent or supplemental reports to be issued pertaining to unresolved or qualified costs, if applicable. In most cases, inclusion of a report qualification that arises from an external impediment (see 10-210.4a.(2)) should be followed up with a comment regarding the intent to supplement the report (see 10-214.1 for a listing of circumstances when a supplemental report should be issued).

(c) In system audits, express appreciation for the contractor’s support and cooperation extended during the audit, if appropriate.

(d) If audit effort was significantly reduced because of self-governance activities (including coordinated audits), express appreciation for the contractor’s cooperation and support. Following is an example of such a paragraph:

“We wish to express our appreciation for the cooperation extended by ABC’s internal audit department during our audit. The coordination of our audit effort with that of the internal auditors enabled us to complete our audit of relocation costs more efficiently.”

(e) If a government technical evaluation was performed in conjunction with the audit, the auditor will normally incorporate the technical report recommendations into the audit conclusions (note the exception discussed under 10-210.4). In such cases the audit report should include an additional statement, such as the following:

“The audit conclusions incorporate the dollar effect of the recommendations in the related government report of technical evaluation performed by [insert name of activity providing the review]. The technical report is enclosed as Appendix [X].”

(f) The availability of the auditor to furnish additional services including attendance at negotiations will be presumed in routine audits. If an offer of special assistance or where auditor attendance at the negotiation conference is considered critical, insert a note to this effect. Since this is likely to be related to significant issues, the note would also be included at the conclusion of the Executive Summary. An illustration of the note is shown below:

“Because the contractor contested certain significant issues raised in our recommendations (see Appendix [X]), we recommend that you invite a DCAA representative to attend the negotiation conference.”

10-210.6 Explanatory Notes

a. Explanatory notes may be omitted in audit reports where there are no findings and the requestor has indicated that the information describing the basis of the cost and the audit evaluation would not be useful at negotiations. See 10-210.5b and c

for a discussion on exhibits and schedules in the results of audit.

b. In reports that question contractor proposed costs, explanatory notes should contain detailed information such that the contracting officer is able to understand clearly the basis for each element of cost, how the cost was evaluated, and the conclusions made on the basis of that evaluation. Explanatory notes should be prepared for each significant cost element. General minimum criteria for the explanatory notes will include:

(1) Summary of Conclusions. Provide a brief summary of the audit exception. Provide the basis for any questioned or unsupported costs including a description of the costs and a specific reference to the regulatory support such as the cost principle, cost accounting standards, or contract terms.

(2) Basis of Contractor's Cost. Describe the basis of the contractor's submitted costs. As appropriate, provide references to the specific parts of the contract submission that provides more detail on the basis.

(3) Audit Evaluation. Provide a description of the audit procedures used to evaluate the cost element. Describe the procedures even if they did not result in questioned, unsupported or unresolved costs. Include details on the calculation of the audit exception. When quantitative methods are used as a basis for the audit conclusions, these methods should be described in the explanation. Include references to any “Qualifications” and fully describe the effect these circumstances have on the submitted costs.

(4) Contractor's Reaction. Provide a statement that the contractor either agreed or disagreed with the auditor's conclusions and the basis for any disagreement.

(5) Auditor's Response. Provide any appropriate comments if the contractor disagrees with the auditor's conclusions.

c. For explanatory notes in types of audit reports that do not deal with proposed costs, i.e., system audits, follow 10-409, Statement of Condition and Recommendation.

10-210.7 Contractor Organization and Systems

This section is designed to give the reader relevant information which impacts the scope and the results of the audit. Tailor it to the contractor's size and where possible, reference previous reports.

a. The "Organization" paragraph should provide relevant background information such as annual sales, percentage of government sales, number of employees, facilities, intercompany relationships, and major services and products provided by the company.

b. The "Systems" paragraphs in internal control audit reports on accounting and management internal control systems, should provide pertinent information on the system (see 5-102). For example, this paragraph could refer to the contractor's written policies and procedures describing the system and briefly summarize the major areas covered by the policies and procedures. See 10-410 for an example of this paragraph. [The results of our internal control audits impact the scope of our financial related audits discussed below (see 3-305.4)].

c. The "Systems" paragraphs in financial related audits other than internal control audits, should provide background information on each relevant internal control accounting and management system that impacts the audit (see 5-100). Include the following information for each relevant system:

(1) a brief description of the system or reference the previous internal control audit report or other reports that contain a description of the system. (If the addressee has not been provided a copy of the referenced report, attach a copy).

(2) our opinion on the overall system [adequate, inadequate, or inadequate in part].

(3) our assessment of control risk. The designation of low, moderate or high is not required but may be used for emphasis if desired. (See 3-300).

(4) a list of outstanding internal control deficiencies --- briefly describe each

deficiency and the status of contractor corrective actions.

d. The assessment of control risk and the deficiencies listed in the "Contractor Organization and Systems" section that impact the area being audited should be discussed in the "Scope of Audit" (see 10-210.3).

e. The cost impact of any deficiencies affecting the audit should be described in the structured notes in the "Results of Audit" section.

f. During the audit, the auditor should ask about contractor's efforts to correct deficiencies and reflect the current status in the "Contractor Organization and Systems" section.

g. The "Contractor Organization and Systems" section should also be updated for new deficiencies observed during the audit (see 10-413).

10-211 DCAA Personnel and Report Authorization (Reports-General)

a. DCAA Personnel. For all reports, identify the primary point of contact for questions regarding the audit and provide telephone, e-mail and fax numbers where he or she can be reached. Include the telephone and fax numbers for the FAO as well as the onsite financial liaison advisor, when applicable. Also provide the DCAA internet address (see Fig. 10-2-3). If an auditor trainee or auditor intern performed the fieldwork, do not identify him or her in this section. In this case, the supervisory auditor or cognizant technical specialist should be identified as the primary point of contact.

b. Signature.

(1) The report will be signed by the auditor authorized to do so in accordance with the provisions of DCAAR 5600.1, "Delegation of Signature Authority for Audit Reports and Other Related Documents," in most cases, the branch manager or resident auditor. No "command" or authority line is used on audit reports. As shown in Figure 10-2-3, "AUDIT REPORT AUTHORIZED BY:" is typed at the left margin below the last line of the narrative. The first line of the signature block is typed on the fifth line below this line.

(2) The signature on reports sent electronically should comply with the DCAA Correspondence Manual, C2.10.2.

/Signed/
ROBERT T. BROWN
Branch Manager
DCAA Arizona Branch Office

If someone other than the FAO manager signs the report use the following electronic signature format.

/s/ S. W. Jones
/for/ John W. Brown
Branch Manager
DCAA Arizona Branch Office

c. Relevant Dates. Use this section in demand assignments, primarily price proposal evaluations. These should include, at a minimum, the dates of ACO and PCO requests and the dates of any extensions. The format should facilitate computation of elapsed days (see Fig. 10-2-3).

10-212 Report Distribution and Restrictions (Reports-General)

10-212.1 General

a. A separate page should be provided, after the signature page, to advise the report recipient of report distribution and restrictions. If e-mail addresses are available, include them for each recipient who is willing to receive the report electronically. The distribution list should properly identify each organization, with the exception of DCAA Field Detachment, which receives a blind copy of audit reports.

b. The report distribution is placed above the report restrictions as illustrated in Figure 10-2-4. Place long distribution lists on a separate sheet or sheets following the signature page; however, the location of such long distributions will be referenced on this page (e.g., see Appendix X, page XX).

c. For OMB Circular A-133 requirements, refer to 13-706.7 and Figure 13-7-1.

d. Other special distribution requirements pertaining to certain types of reports will be stated in the following sections of this chapter. Provide copies of reports on lower tier subcontractors to FAOs cognizant of the upper tier contractor. Provide the name of the upper tier contractor and relevant contract numbers for ease in routing the report.

e. See 10-2S1 for e-mail distribution requirements for U.S. Army Tank-Automotive & Armaments Command (TACOM) – Code DAAE07.

f. A copy of all audit reports for non DoD customers resulting from forward pricing, terminations, equitable adjustment claims, systems and incurred cost audits should be e-mailed to the Senior Non DoD FLA as listed in 15-3S1. Also see 15-100 for distribution requirements pertaining to non-DoD agencies.

g. See Figure 10-2-4 for restriction statements that should be included in reports. Restrictions 1, 2, and 4 in Figure 10-2-4 are mandatory for inclusion in all reports. The language in the figure should be used as shown except that the language in restriction 4 must be modified for the application of agreed-upon procedures reports (10-1011). Restriction 3 should be tailored for release applications as discussed in 10-212.2 and 10-212.3. Restrictions for release of the proposal report to an FMS customer are set forth in 10-307.3. In addition, if the report contains classified information, refer to 10-205.2 for guidance on classification markings. Restrictions used in applications of agreed-upon procedures are set forth in 10-1011.

10-212.2 Release of Audit Reports to the Contractor

a. As provided for in the Government Auditing Standards, DCAA routinely provides copies of draft reports for all audits, except those dealing with negotiation of forecasted costs or those dealing with costs potentially under litigation, to the contractor being audited for review and comment. (See also 4-303 and 4-304 regarding information to be discussed at interim and exit conferences.)

b. Except for the reports described in paragraphs c and d, either a copy of the report, or the Results of Audit section, or the Statement of Condition and Recommendation, and/or other relevant section(s), as appropriate, will be provided to the contractor at the exit conference in draft form for written comment. As discussed in 4-303, the details of significant audit findings are provided to the contractor for comment at the time they are discovered. This allows for quick turnaround once the complete draft report is provided, since all findings will have already been fully discussed with the contractor. The contractor should be provided a reasonable amount of time to analyze the audit results and to submit its response for incorporation into the final report. However, this time should be minimal since the audit issues were discussed on a real-time basis during the evaluation. If the contractor's response is not provided in a timely manner, the final report should be issued stating that the report was provided for comments to the contractor but the comments were not received in time to incorporate them into the final report. If written comments are received after the report was issued, prepare a supplemental report if it will serve a useful purpose.

c. In order to avoid disclosing the government's negotiating position, draft reports that include forecasted costs to be used in negotiations are not provided to the contractor unless specifically authorized by the contracting officer (FAR 15.404-2(c)(1)(i)). The contracting officer may restrict the discussion of source selection information with an offeror (FAR 15.3). However, the auditor should fully discuss with the contractor any factual differences, unsupported items, cost or pricing data inadequacies, and CAS/FAR noncompliances and obtain the contractor's response for inclusion in the final audit report. Draft and final audit reports on the areas listed below are not provided to the contractor unless the contracting officer directs such release in writing.

- Individual Price Proposals
- Should Cost Reviews
- Forward Pricing Rate Proposals
- Evaluations of Part of a Proposal, including audits of specified cost elements and agreed-upon procedures

- FPR/FPI Price Redetermination Proposals, containing forecasted costs
- Equitable Adjustment and Termination Submissions, containing forecasted costs (refer to 12-507 for general guidance concerning equitable adjustment submissions)
- Other evaluations where the PCO restricts release to the contractor

The following contingent release statement shown on Figure 10-2-4 will be included as the third paragraph under "RESTRICTIONS" for these reports:

"The Defense Contract Audit Agency has no objection to release of this report, at the discretion of the contracting agency, to authorized representatives of [*insert name of contractor or subcontractor to which the report pertains*]."

d. Draft and final reports that are of a privileged and sensitive nature (such as those reporting on unsatisfactory conditions (4-803.2) or which make reference to suspected irregular conduct or referral for investigation (4-700)) will not be provided to the contractor. These types of reports are not usually discussed with contractor representatives, and any inquiries concerning disclosure of the report information will be resolved in accordance with DoD 5400.7-R and the DCAA Freedom of Information Act Program.

e. The statement regarding release of the audit report solely at the discretion of the cognizant contracting agency pertains to the complete report including all appendixes. Frequently, a government technical evaluation report may be included as an appendix to the DCAA audit report. If, for any reason, the government activity supplying a technical evaluation has any objection to release of its report to contractor representatives, this must be highlighted under the "Audit Report Distribution and Restrictions" section of the report. For example:

"The Defense Contract Audit Agency has no objection to release of this report. However, do not release the government technical evaluation report included as Appendix XX of our report to [*con-*

tractor or subcontractor name] without approval of *[name of government agency supplying technical report]*.”

f. Except for those reports described above which are not releasable, the final report will show the contractor as a recipient of the report (through the contracting officer). Final reports provided to the contractor through the contracting officer should omit the third paragraph shown in Figure 10-2-4 “RESTRICTIONS” related to DCAA having no objection to the release of the audit report. If the contractor requests a copy of any of these types of final reports after the report has been issued, coordinate with the contracting officer to determine if the contracting officer has any objection to DCAA providing a copy of the report directly to the contractor.

10-212.3 Release of Subcontract Audit Report to the Higher-Tier Contractor --- Proposals or Other Cost Submissions

a. When the report is on a subcontractor's proposal or other cost submission to a higher-tier contractor, the audit report “RESTRICTIONS” must contain a statement regarding the subcontractor's agreement or objection to release of the report or information to the higher-tier contractor. The release statement applies to all subcontract audit reports or summary information. The audit procedures on this matter are discussed in 9-106.4 for price proposals and 6-801.2 for incurred costs. The auditor should determine at the start of the audit whether the subcontractor would have any restrictions on release of the report to the higher-tier contractor. If so, the auditor should also discuss with the requestor if the audit should proceed, and if so, how the audit results could best be presented to provide for release to the higher tier contractor and maximize their usefulness to the recipient. (See 10-212.3d. below.)

b. The comment regarding subcontractor release restrictions will be included under the audit report “RESTRICTIONS.” If a report is issued, the comment will appear either as a stand-alone comment or as a follow-on comment to the sentence provided in

10-212.2e., if required. If a cumulative allowable cost worksheet (CACWS) is issued, the comment may be included as a note in the CACWS.

c. If the subcontractor does not object to release of the report, use the following statements:

(1) If the sentence in 10-212.2c. is required, add the following as the second sentence in this paragraph:

“Nor does this Agency or *[subcontractor name]* object to release of this report to authorized representatives of *[name of higher-tier contractor]*. See Appendix XX for a copy of the subcontractor's release statement.”

(2) If the sentence in 10-212.2c. is not required, the following comment should be used on subcontractor release restrictions:

“*[Name of subcontractor]* does not object to release . . .”

d. If the subcontractor objects to release of all or any part of the report information, use a statement similar to the following:

“The Defense Contract Audit Agency has no objection to release this report, at the discretion of the contracting agency, to the authorized representatives of *[name of contractor or subcontractor to which the report pertains]*. However, please note that *[subcontractor name]* objects to release of this report *[in its entirety]* to the higher-tier contractor, *[higher-tier contractor name]*, because *[briefly summarize the reason(s) for the subcontractor's objection.]* *[If applicable, identify the specific information the subcontractor does not want released, delete ‘in its entirety’ above and add ‘except to the extent that the subcontractor grants permission for its release.’]* See Appendix XX for a copy of the subcontractor's statement of objection to release.”

e. If the subcontractor restricts release of only a portion of the report information (for example, historical labor hours), try

to contain the restricted data in a schedule or appendix that can be conveniently removed from the report. In such a situation, the report “RESTRICTIONS” would include a statement describing what information cannot be released and advise that the report could be released if the restricted data were first removed. For example:

“The Defense Contract Audit Agency has no objection to release of this report, at the discretion of the contracting agency, to authorized representatives of *[insert name of contractor or subcontractor to which the report pertains]*. However, please note that *[subcontractor name]* objects to release of this report to the higher-tier contractor, *[higher-tier contractor name]*, unless Schedule/Appendix XX is first removed, because it contains *[identify the data and briefly state the reason(s) for the subcontractor's objection]*. See Appendix XX for a copy of the subcontractor's statement of objection to release.”

10-213 Appendixes (Reports-General)

a. Appendixes may be used when additional background information is needed to help the reader obtain a full understanding of circumstances or events. Types of appendixes include (1) Other Matters to be Reported; (2) Subcontracts Requiring Contractor Cost Analyses (see 10-308.2); and (3) Chronology of Significant Events for postaward audits, equitable adjustment proposals and claims (see 10-607.1 and 10-1107.1). The appendix entitled “Other Matters to be Reported” (10-308.1) is used to provide information, which cannot be conveniently shown in the exhibits and schedules and to present any financial management matters. Audit reports on annual indirect costs, may include an appendix on billing rates. When material is sufficiently important to an understanding of the audit as to require incorporation into an appendix, the text must specifically identify the appendix and briefly state its relationship to the point being made.

b. Appendixes may also be used when attaching stand alone documents that contain information which is pertinent to the audit. Examples of this type of appendix include such documents as assist audit reports, technical analysis reports, subcontractor release letters, contractor written responses, and indirect rate agreements.

c. When another report is referenced, (for example, when an estimating systems examination has disclosed a deficiency discussed in a price proposal evaluation) and the auditor does not know that the user has access to a copy, the referenced report should be furnished as an appendix.

d. Appendixes should be placed immediately after the Report Distribution and Restrictions section of the report. Refer to the appropriate section in this chapter dealing with the specific type of report being prepared for further guidance on the use of appendixes.

e. Identify appendixes by numbers in consecutive order; e.g., APPENDIX 1, APPENDIX 2, etc.

10-214 Supplemental Reports

10-214.1 Criteria for Use

a. Auditing standards provide for issuance of supplemental audit reports when the auditor subsequently becomes aware of information which, had it been known at the time the report was issued, would have affected the report conclusions.

b. A new report (with a different report number) rather than a supplemental report should be issued when the purpose of the report differs from the purpose of the original report. This is the case when a special report is issued to summarize results of audit in previously issued reports or when a follow-up report is issued on a system audit to determine if the contractor took adequate corrective action on reported findings.

c. A supplemental report has the same purpose as the original report, but generally revises the original report's conclusions or significantly modifies some of the report details. Before preparing a supplemental audit report, contact the contracting officer

to determine if the supplemental report would serve a useful purpose. If not, do not prepare the supplemental report and document your discussion in the working papers.

d. Supplemental DCAA audit reports should be issued when:

(1) Events occurring after report issuance have a material effect on government contract costs. Subsequent to the date of the audit report, the auditor concludes that one or more procedures considered necessary at the time of the audit, in the circumstances then existing, were omitted, if performance of such procedures results in significant findings.

(2) Subsequent to the date of the audit report the auditor became aware that additional facts regarding the subject of audit existed at the report date, and such facts affect the report.

(3) Additional time is needed to perform a complete audit (especially on major proposals, sensitive areas, or where there is potential for significant audit findings), however, circumstances do not permit a due date extension. In this case, a qualified report should be issued advising that a supplemental report will be forthcoming if negotiations have not been concluded and the report will serve a useful purpose.

(4) Relevant and material developments or events occurred after the date of the auditor's report that had a material effect on government contract costs (such as, final determinations or resolutions of contingencies or other matters disclosed in the audit report or that had resulted in a departure from the auditor's standard report), for example:

- Required technical information is received after the audit report is issued and the results have a significant impact on the audit findings [10-304.4f.(1)].
- Additional information is received which is necessary to reflect resolution of unresolved costs contained in the audit report [10-304.4f.(2)].
- Additional supporting information is provided by a contractor during the negotiation conference that would affect the report conclusions. In some cases a memorandum for record/file may substitute for a supplemental audit report (See 9-107).

FAR 15.404-2(c)(3) requires that contracting officers should provide updated information that will significantly affect the audit to the auditor. Auditors should assure that any subsequent audits comply with government auditing standards, including adequate testing of evidential matter and appropriate supervisory review. If this cannot be accomplished, there should be no appearance of concurrence with the updated information or implied amendment of the audit report recommendations.

e. If a report is not being supplemented as described in d. above, but must be issued with minor changes (e.g., to correct minor math errors), it should be marked as "revised" in accordance with 10-214.6 below.

10-214.2 General Requirements for Supplemental Reports

a. A supplemental report need not supersede the original audit report in its entirety. It can be limited to the affected item(s) of cost or other portions of the prior report and need not restate previous information or recommendations. However, when a report has been furnished in electronic format, it may be easier to replace the original report in its entirety. Because electronic reports are furnished to the user in "read-only" format; incorporating replacement pages may present difficulties. The auditor should contact the report user to determine his/her preference regarding receiving a replacement report or receiving one or more replacement pages.

b. If replacement pages are selected, make the task of incorporating revisions as easy as possible for the report recipient(s). Rather than instructing the addressee to make numerous pen and ink changes and page substitutions, it is often easier to replace a complete exhibit or schedule in the original report with a revised exhibit or schedule.

c. If inserting a revised narrative, exhibit, etc. of more or fewer pages than the original would require the renumbering of the complete report, and it is not prudent to replace the original report in its entirety, it is acceptable to leave some pages blank or use decimals after the page numbers to

keep the pages in sequence. For example, assume that the original report exhibit covered pages 5 through 10 and schedule A started on page 11:

(1) If the new exhibit is 8 pages long rather than the original 6, number the last two pages 10.1 and 10.2. No other changes to the original report need be made and schedule A can still begin on page 11.

(2) If the revised exhibit was only 4 pages long rather than the original 6, the last two pages of the revision could include the following statement: "This page intentionally left blank." As in the example above, schedule A would still start on page 11.

d. Dollars examined, questioned costs, unsupported costs, etc. initially reported will frequently require revision as a result of issuance of a supplemental audit report. As a result, performance data previously reported in the DCAA management information system should be revised as appropriate.

10-214.3 Supplemental Report Format

Major components of a supplemental report are listed below. Discussion of the particular elements is contained in the referenced paragraphs. Except where noted, the format and contents of the supplemental report must comply with the basic audit report requirements in 10-204. For example, requirements for an audit report cover would not change, distribution requirements remain the same, etc.

Audit Report Cover Sheet (10-214.4)

Report Narrative (10-214.5)

Subject of Supplemental Audit
Executive Summary of Supplemental Audit
Scope of Supplemental Audit
Qualifications Affecting the Supplemental Audit
Results of Supplemental Audit

10-214.4 Audit Report Cover Sheet

a. The report cover sheet and all supplemented pages should contain the original audit report number followed by the supplement number (e.g., S1, S2, etc.). If the original exhibit is to be replaced by a revised exhibit, all pages of the revised exhibit should show the supplement number.

b. The audit report cover sheet and subject line should identify the audit report as a supplement; for example, "Supplement to Report on Audit of Proposal . . ." Otherwise, the cover sheet, subject, and addressee elements should be identical to the original report.

10-214.5 Report Narrative

The supplemental report can usually be limited to a narrative section setting forth the "Subject" and "Scope of Supplemental Audit," and "Results of Supplemental Audit" together with the attached supplemental exhibits, schedules, or individual pages. Comments on these areas follow:

a. Subject and Scope of Supplemental Audit. State the reason why the supplemental report is being issued. If applicable, mention whether the supplemental audit was limited to specific areas or items of cost. For example:

"This supplemental report incorporates the results of the government report of technical evaluation, which was not received in time to be included in our original audit report dated . . ."

If there are any changes in the scope of audit statement as contained in the original report, make note of it in this paragraph. For example, a comment may be included that the scope of audit qualifications in the original report no longer apply.

b. Results of Supplemental Audit

(1) This paragraph will state the net effect of the supplemental report and the primary reason(s) for the change. For example:

"As a result of the technical review, total questioned costs of \$__ in our original report are revised to \$__, primarily because of recommended reductions to proposed material quantities and manufacturing labor hours."

(2) If applicable, state the name and title of the contractor's designated representative with whom the supplemental results were discussed (10-210.5e).

(3) Provide precise instructions to enable the report recipient to incorporate the new pages, exhibits, etc. into a complete (revised) report. In the example in a. above, extensive changes would be required as a result of incorporating the results of technical review. The original "Scope of Audit" paragraph would probably require revision and the "Qualifications" paragraph in the original report would have to be revised or eliminated in its entirety to delete the technical qualification; the "Results of Audit" paragraph would change to reflect the additional questioned costs and a change in the opinion; the comment on the intention to supplement the report would be eliminated; and the exhibit(s) and or schedule(s) in the original report would change. In this situation, this instruction paragraph would probably state the following:

"This supplemental report replaces our original report in its entirety."

If the original report is not being entirely superseded, instruct the recipient to make pen-and-ink changes or page substitutions. For example:

"Remove pages 2, 4, 6, and 7 from our original report and replace with the attached revised pages. Also, re-number page(s) . . ."

In this case, add the following additional comment:

"Except as noted above, all other comments contained in the original report remain unchanged."

10-214.6 Revised Report Format

If an electronically furnished report is not being supplemented as described in 10-214.1d. above, but is being reissued in its entirety with minor changes (e.g., to correct minor math errors), the word "Revised," in parentheses, should follow the audit report number on the cover sheet and in the header. The revised report should carry a revised date. Do not identify such a superseding audit report as a supplement (see 10-214.4). If subsequent revisions become necessary, they are to be identified as "Revision 2," "Revision 3," etc. The transmittal should identify the minor change(s) unambiguously.

10-215 Transmittal Memorandums and Routing

Report transmittals should not be used to convey information or comments that should be included in the report itself. For this reason, a transmittal memorandum or letter is not normally used for initial distribution of reports. However, it is acceptable to attach a transmittal letter to a report if it is helpful in highlighting an area for the contracting officer's consideration. A transmittal letter could also be used to explain special distribution to officials who seldom receive reports from the FAO. For example, if a report discloses a condition which we have been requested to identify by an entity outside the procurement community, the transmittal memorandum might say:

"In accordance with your standing request to DCAA Headquarters, the attached report is distributed to your office because [*state the condition to be reported.*]"

Figure 10-2-1
Defense Contract Audit Agency Audit Report
DEFENSE CONTRACT AUDIT AGENCY
AUDIT REPORT NO. XXXX-XXXXX21000XXX

June 20, 20XX

PREPARED FOR: Procuring Contracting Officer
ATTN: AIR 2.2.1
Naval Air Systems Command Headquarters
Bldg. 2272
47123 Buse Road Unit IPT
Patuxent, MD 20670-1547

THRU: Administrative Contracting Officer
ATTN: DCMA-GXAF (J. Doe)
Defense Contract Management Agency, Phoenix
Phoenix, AZ 85034-1012

PREPARED BY: DCAA Arizona Branch Office
Honeywell, Inc. Suboffice
Satellite Systems Operations
19019 North 59th Avenue
Glendale, AZ 85308-9650
Telephone No. (602) 561-3112
FAX No. (602) 561-3662
E-mail Address dcaa-faoxxxx@dcaa.mil

SUBJECT: Report on Audit of Firm-Fixed-Price Proposal for Torque
Inverters for Orville I

REFERENCES: PCO: RFP No. N00019-XX-P1-XXXXXX
ACO: Case No. XXX-3A(02)-XX
Prime Contract No.: F33600-91-C-0045
Relevant Dates: See Page 17

CONTRACTOR: High Tech, Inc.
29 Scout Drive
Glendale, AZ 85300

REPORT RELEASE RESTRICTIONS: See Page 18

	<u>Page</u>
CONTENTS:	
Subject of Audit	1
Executive Summary	1
Scope of Audit	3
Results of Audit	4
Contractor Organization and Systems	16
DCAA Personnel and Report Authorization	17
Audit Report Distribution and Restrictions	18
Appendixes	19

FOR OFFICIAL USE ONLY

Figure 10-2-2
Subject of Audit

Audit Report No. XXXX-XXXXX21000XXX

SUBJECT OF AUDIT

As requested by DCMA-Phoenix on May 13, 20XX, we examined the May 13, 20XX firm-fixed-price proposal submitted by High Tech, Inc. (HTI) to determine if the proposed costs are acceptable as a basis to negotiate a fair and reasonable contract price. The \$1,141,268 proposal is for 28 Torque Inverters for the Orville I aircraft. This is a product made by this contractor on a sole source basis for the past five years, delivering the last order in December 20XX. The proposed performance period is August through November 20XX.

The proposal and related cost or pricing data are the responsibility of HTI. Our responsibility is to express an opinion on the proposal based on our examination.

EXECUTIVE SUMMARY

Our examination of the \$1.1 million proposal disclosed \$169,000 of questioned costs, including the following significant items:

Material	\$86,000
Labor	9,000
Indirect expenses	66,000

The proposal is acceptable for negotiation of a fair and reasonable price. However, the significant issues described below should be considered in the negotiation process.

SIGNIFICANT ISSUES

1. The results are qualified because (i) we have not yet received a response to our request for technical assistance regarding purchased parts as discussed on page 4 and engineering labor as discussed on page 7 and (ii) HTI's noncompliance with CAS 401.
2. Costs proposed are overstated as follows:
 - a. Material costs by 24 percent because of numerous pricing errors as a result of an outstanding estimating deficiency.
 - b. Manufacturing labor costs by 12 percent because it did not use the appropriate historical accounting data in the improvement curve application.
3. Indirect expenses associated with questioned base amounts are also questioned.

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**Figure 10-2-3
DCAA Personnel**

Audit Report No. XXXX-XXXXX21000XXX

DCAA PERSONNEL

Primary contacts regarding this audit: Telephone No.

Mary E. Green, Senior Auditor	(602) 561-3112
Kay J. Jones, Supervisory Auditor	(602) 561-3112

Other contacts regarding this audit report:

John W. Brown, Branch Manager	(602) 379-4102
John A. Smith, Financial Liaison Advisor	(301) 757-7852

FAX No.
(602) 379-4601
(301) 757-7866 (FLA)

E-mail Address
dcaa-faoxxxx@dcaa.mil

General information on audit matters is available at <http://www.dcaa.mil>.

RELEVANT DATES

Request for Audit: PCO -- dated May 13, 20XX; received May 14, 20XX
ACO -- dated May 14, 20XX; received May 14, 20XX

AUDIT REPORT AUTHORIZED BY:

John W. Brown
Branch Manager
DCAA Arizona Branch Office

Figure 10-2-4
Audit Report Distribution and Restrictions

Audit Report No. XXXX-XXXXX21000XXX

AUDIT REPORT DISTRIBUTION AND RESTRICTIONS

DISTRIBUTION

Procuring Contracting Officer
ATTN: AIR 2.2.1
Naval Air Systems Command Headquarters
Bldg. 2272
47123 Buse Road Unit IPT
Patuxent, MD 20670-1547

E-mail Address
grayjs.jfk@navair.navy.mil

Administrative Contracting Officer
ATTN: DCMA-GXAF (J. Doe)
Defense Contract Management Agency
Phoenix, AZ 85034-1012

jdoe@dcma.mil

Naval Air Systems Command
ATTN: DCAA FLA (J. A. Smith)
Bldg. 2272 AIR 2.0
47123 Buse Road Unit IPT
Patuxent, MD 20670-1547

dcaa-pla-navair@dcaa.mil

Telephone No.
(301) 757-7852

RESTRICTIONS

1. Information contained in this audit report may be proprietary. It is not practical to identify during the conduct of the audit those elements of the data which are proprietary. Make proprietary determinations in the event of an external request for access. Consider the restrictions of 18 U.S.C. 1905 before releasing this information to the public.
2. Under the provisions of Title 32, Code of Federal Regulations, Part 290.7(b), DCAA will refer any Freedom of Information Act requests for audit reports received to the cognizant contracting agency for determination as to releasability and a direct response to the requestor.
3. The Defense Contract Audit Agency has no objection to release of this report, at the discretion of the contracting agency, to authorized representatives of HTI.
4. Do not use the information contained in this audit report for purposes other than action on the subject of this audit without first discussing its applicability with the auditor.

10-2S1 Supplement -- E-mail Distribution of Reports

In cases where DCAA offices provide information copies of DCAA self-initiated audits or DCMA requested reports to the U.S. Army Tank-Automotive & Armaments Command (TACOM) – Warren procurement offices (identified by

Army Activity Address Number DAAE07), the reports should be e-mailed to dcaaauditreports@tacom.army.mil. See 10-6S1 for distribution of defective pricing reports on any TACOM contract.

10-300 Section 3 --- Audit Reports on Price Proposals

10-301 Introduction (Proposal Reports)

a. This section presents guidance for preparing and distributing audit reports on:

- audit requests on pricing proposals for all types of negotiated contracts and modifications, (10-304) and
- audits of parts of a proposal, (10-305).

b. Guidance on reporting applications of agreed-upon procedures and cost realism analyses may be found in section 10-1000, Reports on Application of Agreed-Upon Procedures. Applications of agreed-upon procedures to price proposals are similar to other applications of agreed-upon procedures.

c. Audits of incurred costs under repricing proposals for incentive and price re-terminable fixed-price contracts are similar to other contract closeout audits. See 10-900 for reporting guidance on these types of audits.

d. Guidance on audit reports related to contract claims is in 10-1100.

10-302 Report Format and Contents (Proposal Reports)

a. General report requirements are set forth in 10-200. "Shell" reports containing the new report format are provided on the APPS and the DCAA Intranet. The audit report should contain the necessary and pertinent information disclosed by the audit, which will assist the contracting officer in negotiating with the contractor.

b. The auditor should coordinate with the customer while planning the audit. Reports should comment on areas emphasized in the request. For example, customers may want historical rate information, current proposed and recommended rates, or details on specific proposed costs.

c. Major audit report components are listed below in the sequence in which they generally appear. They are discussed in detail in the referenced paragraphs. Those components highlighted with an asterisk should appear in every DCAA forward pricing audit report.

Audit Report Cover Sheet (10-205)*

Report Narrative (10-304)*

Subject of Audit (10-304.1)*

Executive Summary (10-304.2)

Scope of Audit (10-304.3)*

Qualifications (10-304.4)

Results of Audit (10-304.5)*

Opinion (10-304.6)*

Exhibits and Schedules (10-304.7)

Additional Remarks (10-304.10)

Contractor Organization and Systems (10-306)*

DCAA Personnel and Report Authorization (10-211)*

Report Distribution and Restrictions (10-212)*

Appendixes (10-308)

10-303 Addressing and Distributing Reports (Proposal Reports)

10-303.1 Reports on Prime Contract Proposals

a. Reports on price proposal audits will usually be addressed to the individual who has responsibility for negotiating the proposal. This is either the PCO or the plant representative/ACO (if the PCO has delegated negotiation authority). (See 10-206 for general policy on addressing reports.) If there is doubt about the correct addressee, ask the plant representative/ACO if she or he has been delegated procurement authority to execute the contract pricing action involved.

b. If the report is addressed to the PCO (other than the plant representative/ACO acting as a PCO), and DoD field pricing support procedures apply (9-100), provide the original copy of the report to the plant representative/ACO for transmittal to the PCO. "Thru" addressing may be used for this purpose (see 10-206.4).

c. If "thru" addressing is used, provide an advance copy of the report to the PCO. This will allow the PCO to begin advance preparation for negotiations. A routing slip may be used for this purpose. In such cases, the audit report distribution list (10-212) should identify this advance distribution to the PCO.

d. Provide a copy of the report to the appropriate FLA (see 15-3S1). Also provide a copy of each prime contract price proposal audit report to the NASA OIG Center Director (see 15-1S1) if NASA so requests.

10-303.2 Reports on Intracompany and Subcontract Proposals

a. If this is a DoD procurement (9-100 and FAR 15.404-2 /DFARS 215.404-2), an audit report of an intracompany or subcontractor proposal will be addressed to the plant representative/ACO responsible for the segment or subcontractor submitting the proposal. Copies of the audit report will be distributed to the plant representative/ACO and auditor cognizant of the upper tier contractor. Note that the assist audit report should still be addressed and distributed in the above manner even if the assist audit was requested by DCAA (see 9-104.2 and 9-104.4).

b. If the procurement is not for DoD or is a foreign direct sale, and the PCO requests audit assistance directly from the prime contractor auditor, address the reports on audits of subcontractor and intercompany proposals to the requesting PCO. Provide a copy to the plant representative/ACO responsible for the audited segment or subcontractor, unless he or she expressly prefers not to receive copies of such reports.

10-304 Report Narrative (Proposal Reports)

10-304.1 Subject of Audit

a. This section refers to the audit request and identifies the contractor's assertion by stating the nature and amount of the pricing action (See 10-210.1). The opening statement could read as follows:

"As requested by DCMA-Phoenix on May 13, 20XX, we examined the ABC Company's May 13, 20XX firm-fixed-price proposal submitted in response to RFP number N00019-XX-P1-XXXXX to determine if the proposed costs are acceptable as a basis to negotiate a fair and reasonable contract

price. The \$1,141,286 proposal is for production of 28 Torque Inverters for the Orville I aircraft. The Company proposed a performance period of November 1, 20XX through June 30, 20XX."

"The proposal and related cost or pricing data [*or information other than cost and pricing data*] are the responsibility of the contractor. Our responsibility is to express an opinion on the proposal based on our examination."

When the auditor participated as a member of an IPT, the second paragraph should read as follows:

"The contracting officer formed an Integrated Product Team (IPT) to effectively and efficiently manage the subject acquisition. At the request of the contracting officer, DCAA participated as a member of the IPT, but did not prepare the proposal. The proposal and related cost or pricing data [*or information other than cost and pricing data*] are the responsibility of the contractor. Our responsibility is to express an opinion on the proposal based on our examination."

b. Modify the opening for any additional cost or pricing data or information other than cost and pricing data submissions that were audited (e.g., a revised submission or supplemental data).

10-304.2 Executive Summary

a. The Executive Summary highlights the audit results and the significant issues, findings, recommendations and/or qualifications (see 10-210.2). Details are provided in the "Results of Audit" section, along with the explanatory notes, exhibits and schedules. Examples of results, which may trigger the need for an Executive Summary are:

- Adverse or Disclaimer of opinion (see 10-304.2c)
- Significant questioned, unsupported or unresolved costs

- Significant estimating system deficiencies
- Recommendation to delay contract negotiation
- Significant qualifications
- Significant instances of CAS or FAR noncompliance

b. Begin this paragraph with a summary of the amounts questioned, unsupported, or unresolved in relation to the amount proposed. Wherever possible, describe the major components of the questioned costs and state whether the proposal is [or is not] acceptable as a basis for negotiation. For example, a summary statement might read:

“Our examination of the \$1.1 million proposal disclosed \$169,000 of questioned costs, including the following significant items:

Material	\$86,000
Labor	9,000
Indirect expenses	66,000

The proposal is acceptable for negotiation of a fair and reasonable price; however, the significant issues described below should be considered in the negotiation process.

SIGNIFICANT ISSUES:

1. The results are qualified because (i) we have not received our requested technical analysis of purchased parts (see page 5) and engineering labor (see page 7) and (ii) the contractor is in noncompliance with CAS 401 (see page 6).
2. The contractor overstated:
 - a. Material costs by 24 percent because of numerous pricing errors as a result of an outstanding estimating deficiency.
 - b. Manufacturing and labor costs by 12 percent because it did not use the appropriate historical accounting data in the improvement curve application.
3. Indirect expenses associated with questioned base costs are also questioned.”

c. Do not include dollar amounts in the Executive Summary when an adverse opin-

ion is issued in an audit report. Including dollar amounts for exceptions found might give the negotiator the impression that audit exceptions may be used for negotiating a contract price.

10-304.3 Scope of Audit

a. Every audit report requires a description of the work performed (see 10-210.3). The scope paragraph for proposal audits addresses the following:

- Generally accepted government auditing standards
- Evaluation criteria (FAR, DFARS, other Agency supplement regulations, and CAS)
- Internal control structure (assessed control risk)
- Qualifications (10-304.4)

b. Following is the mandatory scope paragraph. Auditors should adjust the criteria (i.e. applicable regulations and/or law) to fit the situation.

“Except for the qualifications discussed below (*omit if there is no “Qualifications” section within the “Scope” paragraph*), we conducted our examination in accordance with generally accepted government auditing standards. Those standards require that we plan and perform the examination to obtain reasonable assurance that the proposal is free of material misstatement. An examination includes:

- evaluating the contractor's internal controls, assessing control risk, and determining the extent of audit testing needed based on the control risk assessment;
- examining, on a test basis, evidence supporting the amounts and disclosures in the proposal;
- assessing the accounting principles used and significant estimates made by the contractor;
- evaluating the overall proposal presentation; and
- determining the need for technical specialist assistance [*and quantifying the results of a government technical evaluation report*].

We evaluated the proposed costs using the applicable requirements contained in the:

- Federal Acquisition Regulation (FAR);
- Defense FAR Supplement (DFARS) [*for non-DoD agencies, identify specific agency supplement - see 15-102.3*]; and
- Cost Accounting Standards (CAS) [*only if the potential contract will be CAS covered*].”

c. The next paragraph in the Scope of Audit section should comment on the current status of the contractor's accounting and estimating systems and the impact of the current assessment of control risk on the scope of audit. Coordinate this information with the “Contractor Organization and System” section (see 10-306). Outstanding deficiencies that impact the scope of audit should be disclosed until those deficiencies are corrected (see 5-1217). For a contractor where an estimating system audit has been performed, these comments might read as follows:

“We consider ABC's estimating system adequate [*or inadequate, or inadequate in part*]” [*if cost and pricing data*] “to ensure that the proposal and final certified contract prices are based on accurate, complete, and current cost or pricing data” [*if information other than cost or pricing data*] “for preparation of the proposal (see Contractor Organization and System section).” [*Briefly describe the impact of any outstanding deficiencies on the audit scope.*] The scope of our examination reflects our assessment of control risk and includes audit tests designed to provide a reasonable basis for our opinion.”

For a nonmajor contractor where an estimating system audit has not been performed, the following comments may be appropriate:

“The scope of our examination reflects our assessment of control risk and includes tests of compliance with

applicable laws and regulations that we believe provide a reasonable basis for our opinion. Our assessment of control risk reflects that we have not specifically examined ABC's estimating system and its related internal controls.”

10-304.4 Qualifications

a. The purpose of this subheading within the scope of audit section is to disclose any circumstances, which necessitate a qualified opinion (see 9-212.2). This paragraph would include only circumstances that have a material impact on the conduct of the audit and its results. Briefly describe each qualification including the impact the qualification had on the scope and results of audit. Specifically reference the report page number, exhibit, schedule, or appendix paragraph which contains the detailed discussion on the item involved. The qualifications section itself must state the negative impact clearly and concisely and provide an estimate of its magnitude. If a monetary impact can not be provided, make a recommendation to the contracting officer of action(s), which will protect the government's interest. When further information is necessary, the qualifications section should reference its location within the audit report. Although Agency guidance specifically permits reference to an appendix, ordinarily a matter which has sufficient impact to justify a report qualification will also affect an element of the costs proposed. The preferred location for the detailed discussion of the item involved is therefore the results of audit, rather than in an appendix. If an appendix is used, it must be tailored to the proposal under evaluation. If the potential impact of the qualification on the subject proposal is not material, the report should not be qualified.

b. The FLAs have been asked to bring any audit reports which appear to have inappropriate qualifications to the attention of the Auditing Standards Division (PAS) in Headquarters. Such reports will be forwarded to the cognizant Regional Director, who will be asked to furnish his personal assessment to Headquarters.

c. Examples of items to be noted in the qualifications paragraph include:

- (1) lack of access to contractor records, including budgetary data (see 1-504)
- (2) time limitations on the scope of audit
- (3) failure to obtain the results of a requested assist audit or technical analysis
- (4) estimating system deficiencies that result in either significant unsupported costs or an estimate which is not current, accurate, and complete
- (5) instances of CAS or FAR noncompliance when the impact of these deficiencies could not be determined on the proposal being audited; however, these deficiencies are not considered significant enough to warrant an adverse opinion
- (6) deficiencies which render the accounting system inadequate for the contract type proposed
- (7) incomplete historical cost audits for prior years when the forecasted rates or recommended rates are based on those prior years
- (8) major contractor acquisitions, mergers and internal reorganizations that are so significant that the effect on the price proposal cannot be reasonably determined but is expected to be material.

The following subparagraphs provide additional information on these examples:

d. If the contractor has denied access to records or other pertinent data, identify the records or data and describe the resulting restrictions or limitations on the scope of the audit. (See FAR 15.404-2(d).) Sample statements describing an access to records problem and a contractor's failure to provide budgetary forecasts follow:

"We were denied access to labor cost estimating worksheets that are required to adequately evaluate the direct labor cost included in the proposal. We discussed this condition with Mr. R. Smith, ABC's Controller, on October 1, 20XX and notified Mr. J. Jones, ACO, of the denial of access by telephone and memorandum on October 2, 20XX. See Page 6, Note 4 for further discussion. We were unable to evaluate this cost by other audit procedures. Therefore, the audit results are qualified to the extent that an examination of the records denied may disclose additional questioned costs."

"The contractor has not prepared budgetary forecasts for the entire proposed period of contract performance. [*Briefly explain what cost elements and period are not covered.*] In our opinion, comprehensive budgetary data are required to facilitate the preparation of reliable cost estimates and as a basis for financial control over costs during contract performance. We were unable to determine by other audit procedures the possible impact that budgetary data would have on the proposed direct costs, indirect expense rates, and related allocation bases. Our opinion regarding these costs is therefore qualified."

"We discussed this deficiency with Mr. R. Smith, ABC's Controller on October 10, 20XX. Mr. Smith stated that ABC will prepare the budgetary forecasts and submit a revised proposal by October 20, 20XX. Upon receipt of a revised proposal, we will provide a supplemental report if contract negotiations have not been completed and the supplemental report will serve a useful purpose."

e. When the scope of audit is limited because of insufficient time, clearly indicate those areas in which an audit was not accomplished (9-212.4). State if additional time was requested but not granted, or granted only in part. An example of a statement to be included in this situation follows:

"We were unable to complete our examination of labor cost because of time limitations. [*Briefly explain the reasons why time was insufficient.*] We requested an extension of the audit report due date from Col. R. Jones on October 10, 20XX. The requested extension was not granted because [*briefly explain reason*]. Therefore, the results of our examination are qualified to the extent that a supplemental examination of labor cost may disclose additional questioned costs. See page 15, Note 5, for further discussion."

f. If a requested technical or assist audit report is not received in time to be incorporated into the audit report, state that fact and, if known, the reasons for nonreceipt.

(1) Nonreceipt of technical input. Provide a brief comment on the follow-up action taken to obtain the required technical information or report. State whether the technical evaluation will be performed and identify the organization responsible for performing it. Also provide a brief comment on the status of the technical evaluation, if known, and on any future reporting action contemplated after receipt of the report. If the required technical information is received after the audit report has been issued, prepare a supplemental report if it would serve a useful purpose at negotiations. (Further guidance on reporting the use of technical specialist assistance is provided in D-300. Detailed examples of report qualification statements are also presented in D-300.)

(2) Nonreceipt of Assist Audit Report. An example of a statement that could be used when waiting for an assist audit report follows:

“Analysis of available documentation in the contractor's files applicable to proposed subcontract costs showed that an evaluation by another DCAA office is needed to reach a definitive conclusion regarding the acceptability of the proposed subcontract costs. We requested an assist audit from our DCAA Resident Office at ABC Corporation. However, we did not receive the results in time for incorporation into this report. We anticipate receipt of the assist audit report on or about October 15, 20XX. The results of the assist audit are considered essential to the conclusion of this examination. Therefore, the audit results are qualified to the extent that additional costs may be questioned based on the results of the assist audit of proposed subcontract costs. See page 16, Note 7, for further discussion. Upon receipt of the assist audit report, we will provide a supplemental report if contract negotiations have not been concluded and the

supplemental report would serve a useful purpose.”

This example assumes that the results of the assist audit are considered essential and that the “Results of Audit” will recommend that negotiations not be held until the assist audit results are considered. The qualification should not be included if the assist audit results are not considered essential to the conclusion of the audit and negotiations.

g. If estimating deficiencies discovered during the proposal audit result in either significant unsupported costs or an estimate which is not current, accurate, and complete, provide a brief explanation of the deficient condition and the specific action required to correct it. (See 5-1217, 9-205, 9-310, and 10-413 for specific actions required.)

(1) An example of a qualification statement covering unsupported costs might read:

“A significant proportion of the contractor's proposed costs is unsupported. We sought the assistance of both the ACO and PCO and advised them on October 10, 20XX of the items and the types of documentation necessary to support the costs (see Page 9, Note 8). If the contractor furnishes adequate supporting documentation prior to negotiations, we will provide a supplemental report to dispose of the unsupported costs if such a report would serve a useful purpose.”

(2) An example of a qualification statement covering an estimating deficiency discovered during the audit of a price proposal follows:

“We consider the procedure by which the contractor estimated the proposed direct labor cost to be unacceptable because the proposed hourly rates include unreasonable and unsupported increases for wage escalations. To correct the deficiency cited the contractor must develop new labor rates commensurate with the most recent union contract. A detailed discussion

of the circumstances is presented on page __, Note __, of the Results of Audit.”

(3) As noted in the above qualification statement, a detailed discussion of the deficient condition should be included in the explanatory notes within the “Results of Audit” section.

(4) DFARS 215.407-5-70(g) requires that once a significant estimating system deficiency is cited, subsequent field pricing reports will mention the outstanding deficiency until it is resolved. Accordingly, the discovered deficiency should be added to the list of outstanding estimating deficiencies in the “Contractor Organization and Systems” section of the report (see 10-306). This listing should include a brief description of the deficiency and the status of contractor actions.

h. If instances of CAS and FAR non-compliance have a significant effect on the evaluation or the audit results, state this and define the specific corrective action the contractor needs to take. A detailed discussion of the deficient condition should be provided in the Contractor Organization and Systems section.

i. If the contractor's accounting system is inadequate to determine the costs under the contract type proposed, state this and identify the contractor action required to make the accounting system adequate. A detailed discussion should be provided in the Contractor Organization and Systems section of the report narrative.

j. If the only effective method available to the auditor for evaluating proposed indirect forward pricing rates requires reliance on the results of historical overhead audits for prior years, and such historical audits are not reasonably current, the circumstances should be described and the potential effect on the audit conclusions defined (see 9-702.2).

k. If the contractor is involved in a major acquisition, merger, or internal reorganization that is estimated to have a material impact on direct costs and indirect rates, state this and recommend a savings clause if appropriate. A detailed discussion should be provided in the Contractor Organization and Systems section of the report.

10-304.5 Results of Audit

The Results of Audit section for forward pricing proposals consists of the following subsections which are discussed in greater detail below:

- Audit Opinion (10-304.6)
- Contractor's Submission and Audit Evaluation (10-304.7)
- Questioned, Unsupported and Unresolved Cost (10-304.8)
- Difference (10-304.9)
- Additional Remarks (10-304.10)

10-304.6 Audit Opinion - Pricings

Begin this section with the opinion paragraph. Reporting standards (see Chapter 2) require that the auditor express an opinion on the adequacy of submitted cost or pricing data or information other than cost and pricing data, compliance of the proposal with applicable regulations, such as FAR, Part 31 and CAS, and the acceptability of the overall proposal for negotiation of a fair and reasonable price. 9-212 provides additional information about the types of audit opinion.

a. The auditor's opinion on the assertion and submitted cost or pricing data or information other than cost and pricing data generally can be categorized in one of the following three areas:

- completely acceptable (adequate),
- generally acceptable except for some minor deficiency (inadequate in part), or
- unacceptable (not adequate).

FAR, Part 15 is often used in determining if the assertion is adequate (see 9-200). Additionally, the proposal may be in various degrees of compliance with promulgated Cost Accounting Standards or FAR, Part 31. For reporting purposes, these include:

- no instances,
- insignificant instances, or
- significant instances of noncompliance.

b. The auditor's opinion serves as the basis for the overall opinion on the acceptability of the proposal for negotiation of a fair and reasonable price. For example, an opinion that the assertion is not adequate or that significant FAR and CAS noncompli-

ances exist (and their impact could not be determined on the proposal) will likely result in an overall opinion that the proposal is not acceptable as a basis for negotiation of a fair and reasonable price.

c. The following table, along with the subsequent paragraphs, can help to prepare an appropriate opinion paragraph. To use the table, read down and across under the appropriate categories for adequacy

and compliance. The numbers where the lines intersect represent the corresponding numbers of the sentences found in Section d, Opinion Statements. Combine these sentences in the order shown to present a complete opinion statement for the report. Minor changes in wording, such as references to proper exhibits, pages and notes should be made to fit each specific report.

	Adequacy of Cost or Pricing Data or Information Other Than Cost or Pricing Data			
FAR/CAS Noncompliance	Adequate (9-212.1)	Inadequate In Part (9-212.2)	Not Adequate Contractor's Fault (9-212.3)	Not Adequate and Access to Data Denied (9-212.4)
No Instances	1,5,8 (1,5,15)*	2,5,13 (2,5,15)*	5,3,10	5,4,10
Insignificant Instances	1,6,12 (1,6,15)*	2,6,14 (2,6,15)*	6,3,10	6,4,10
Significant Instances	1,7,9	2,7,9	3,7,11	4,7,11

*Use these paragraphs when recommending that price negotiations not be concluded for a reason not resulting from the contractor's action or inaction (e.g., nonreceipt of a technical or assist audit report) (see 9-212; also see Appendix D-303 for examples of opinion statements qualified for nonreceipt of a government technical evaluation). If significant noncompliances or inadequate cost or pricing data or information other than cost or pricing data are encountered, an appropriate combination ending with paragraph 9, 10, or 11 should be selected.

d. Opinion Statements. The following sentences (referenced in the above matrix) comment on the adequacy of the cost or pricing data or information other than cost or pricing data and the degree of compliance of the proposal with CAS and FAR and, when combined, provide a summary opinion statement on these issues. The comments on compliance with appropriate provisions of FAR generally relate to FAR, Part 31 on the cost principles. The contractor's degree of compliance with FAR, Part 15 serves as the basis for the opinion on the adequacy

of cost or pricing data. If the report includes a qualification paragraph within the scope of audit, the audit opinion must be qualified. The audit opinion should be referenced to the qualification statement that resulted in the qualified opinion. Every audit opinion should start with the words "In our opinion." Add "In our opinion" to the beginning of the sentence in the matrix selected to be first.

(1) "The offeror has submitted adequate cost or pricing data [*or information other than cost or pricing data*]."

(2) "The cost or pricing data [*or information other than cost or pricing data*] submitted by the offeror are inadequate in part (see comments on page __, Exhibit __, Note __). However, the inadequacies described are considered to have limited impact on the subject proposal."

(3) "The cost or pricing data [*or information other than cost or pricing data*] submitted by the offeror are not adequate (see comments on page __, Exhibit __, Note __)."

(4) "The cost or pricing data [*or information other than cost or pricing*

data] submitted by the offeror are not adequate (see comments on page __, Exhibit __, Note __). In addition, the offeror denied access to data needed to evaluate the proposal, as described in the Qualifications section of the report.” [Before this paragraph is used in the report, (a) it should be cleared with the regional office, (b) the ACO and PCO should be advised and (c) the contractor should be informed of its content. Identify the specific data denied and explain why it is needed (see 9-205).]

(5) “The proposal was prepared in accordance with [if CAS covered, add “applicable Cost Accounting Standards and”] appropriate provisions of FAR” [if an agency supplement to FAR applies (9-102.2 and 15-102.3), add “and the (name the agency) Supplement”].

(6) “The proposal was not prepared in all respects in accordance with [if CAS covered, add “applicable Cost Accounting Standards and”] appropriate provisions of FAR” [if an agency supplement to FAR applies (9-102.2 and 15-102.3), add “and the (name the agency) Supplement”]. However, as discussed on page __, Exhibit __, Note __, the impact of the noncompliances is considered relatively insignificant.”

(7) “The proposal was not prepared in all respects in accordance with [if CAS covered, add “applicable Cost Accounting Standards and”] appropriate provisions of FAR [if an agency supplement to FAR applies (9-102.2 and 15-102.3), add “and the (name the agency) Supplement”] (see comments on page __, Exhibit __, Note __).”

(8) “Therefore, we consider the proposal to be acceptable as a basis for negotiation of a fair and reasonable price.”

(9) “Because the [FAR and/or CAS] noncompliances are considered significant, we do not believe the proposal is an acceptable basis for negotiation of a fair and reasonable price, as discussed with [contracting officer or representative] by [auditor] of our office on [date] and as confirmed in our [memorandum/letter] to you dated [date]. At your request, we have, nevertheless, evaluated the proposal to the extent possible in the circumstances.”

(10) “Because the cost or pricing data [or information other than cost or pricing

data] inadequacies are considered significant, we do not believe the proposal is an acceptable basis for negotiation of a fair and reasonable price, as discussed with [contracting officer or representative] by [auditor] of our office on [date] and as confirmed in our [memorandum/letter] to you dated [date]. To make the cost or pricing data [or information other than cost or pricing data] adequate, the offeror must [insert offeror actions needed to resolve the noted inadequacies/deficiencies]. At your request, we have, nevertheless, evaluated the proposal to the extent possible in the circumstances.”

(11) “Because the noncompliances and inadequacies are considered significant, we do not believe the proposal is an acceptable basis for negotiation of a fair and reasonable price, as discussed with [contracting officer or representative] by [auditor] of our office on [date] and as confirmed in our [memorandum/letter] to you dated [date]. To make the cost or pricing data adequate, the offeror must [insert offeror actions needed to resolve the noted inadequacies and/or deficiencies]. At your request, we have, nevertheless, evaluated the proposal to the extent possible in the circumstances.”

(12) “Because the [FAR and/or CAS] noncompliances are considered insignificant, we believe that the proposal is an acceptable basis for negotiation of a fair and reasonable price.”

(13) “Because the cost or pricing data [or information other than cost or pricing data] inadequacies are considered insignificant, we believe that the proposal is an acceptable basis for negotiation of a fair and reasonable price.”

(14) “Because the noncompliances and inadequacies are considered insignificant, we believe that the proposal is an acceptable basis for negotiation of a fair and reasonable price.”

(15) “Nevertheless, in our opinion, the [name the item(s) considered essential] discussed in the Qualifications section of the report [is/are] significant enough to materially impact the results of the audit. Therefore, as discussed with [contracting officer or representative name and title] by [auditor] of our office on [date], we recommend that contract price negotiations not be concluded until the results of

[*item(s) needed*] are considered by the contracting officer.”

e. Disclaimer of Opinion. In rare instances constraints may be placed upon the auditor by the requestor (see 9-212.4a.) which necessitate a disclaimer of opinion. In these instances follow the specific guidance in 10-200 in issuing a disclaimer of opinion.

10-304.7 Contractor's Submission and Audit Evaluation

The second part of the “Results of Audit” section should present the contractor's submission and audit results by cost element in an exhibit type format with appropriate explanatory notes.

a. Exhibits and schedules included in the report will state the results of audit using columns labeled “Questioned Costs,” “Unsupported Costs,” and “Unresolved Costs” (see 10-304.8). These columns should be used only if costs are to be reported in them; otherwise, they should be omitted from the format. The exhibits and schedules should be supported by explanatory notes and where appropriate, cross-referenced to the narrative body of the report.

b. A “Differences” column (proposed cost less questioned, unsupported and unresolved costs by element) may be included at the right of the exhibit if this would be of value to the requestor.

c. Explanatory Notes. The auditor should use a structured format to give the reader a clear and complete presentation of the audit results and recommendations on all items in the contractor's proposal (see 10-210.6). Use the following subheadings, as appropriate, to structure your notes for each significant cost element in the contractor's proposal.

- Summary of Conclusions
- Basis of Contractor's Cost
- Audit Evaluation
- Contractor's Reaction
- Auditor's Response

d. Audit Evaluation. When quantitative methods are used as a basis for the audit conclusions, this should be mentioned in the audit evaluation portion of the explanatory note for the individual cost elements examined. The note should adequately explain the computations and rationale supporting your

conclusion; however, it need not include statistical measurements which are not relevant to price negotiations. For example, comments on confidence levels or confidence limits should not be included in audit reports unless the contractor has cited confidence intervals in its proposal as support for predicted costs.

(1) When costs are questioned based on a statistical sample, the report need not present the sampling plan, recommendations on individual items examined, or calculations of questioned costs if the contractor has agreed with the audit conclusions. For example, the explanatory note might state:

“We applied scientific sampling techniques to the raw material cost estimate. We tested selected items by comparison with the quantitative requirements shown in the bill of material that the government technical representative recommended for acceptance. We compared the dollar values for the selected items with the latest vendor quotations. We consider the contractor's solicitation of prospective sources adequate. In a number of instances, however, the material quantities or prices included in the contractor's estimate exceeded the requirements or lowest quotations, without adequate justification. Applying statistical projection techniques to this cost category on the basis of the exceptions noted, we questioned \$80,000 in estimated raw material costs.”

(2) When costs are questioned based on a regression analysis or an improvement curve, the auditor's explanatory note should identify data used in the analysis and explain any differences between these data and amounts appearing in the contractor's cost representations. Graphic presentations of regression lines and improvement curves, whenever practical, should be included in the audit report. The report may also include computer printouts when there are indications that negotiators will find this information valuable during negotiations.

e. If you have comments on profit, they should be provided in the explanatory

notes and be prepared in accordance with 9-900. Normally comments are limited to items that might affect quantifying weighted guideline factors. Do not show percentage computations under the weighted guideline method or application of an incentive profit formula either here or in an exhibit or schedule of the report. Examples of comments on the profit factor, "Contractor's Performance Risk -- Cost Considerations," are shown below (see 9-900 for other factors to be covered):

"The contractor does not consistently base its proposed unit prices on the latest production labor hours and material prices incurred for the same or similar units. Details on this estimating deficiency are presented in our Report on Review of XYZ Company's Estimating System (09900-20XXA24000001, dated November 30, 20XX). Specific reference to the deficiency and discussion of its impact on this pricing action are included on page 7, Notes 2 and 3, and Appendix 2."

"The contractor has three engineering departments which differ greatly in the proportion of journeyman engineers and notable or scarce engineering talent employed in each department. This proposal is based on engineering performance by the department having the least amount of notable engineering specialties and the lowest level of engineering experience."

f. If specific elements of the explanatory notes are redundant (e.g., Basis of Contractor's Cost or Contractor's Reaction) they may be efficiently presented as a common note.

g. If there are a number of exhibits and schedules, that are best presented on separate pages, move them and the explanatory notes to the end of the Results of Audit section (after "Additional Remarks") and begin each exhibit and schedule on a separate page. A sample statement describing this realignment might read:

"We included appropriate exhibits and schedules detailing the contractor's

submissions and our audit evaluation beginning with Exhibit A, page _."

h. Where we have no findings and the requestor has indicated that the information describing the basis of the cost and the audit evaluation would not be useful at negotiations; the auditor may include a brief statement, after the audit opinion, that the audit found no questioned, unsupported, or unresolved items. The usual exhibits, schedules and explanatory notes may be omitted.

10-304.8 Questioned, Unsupported and Unresolved Cost

a. CAM should not be cited as the reason for treating costs as questioned, unsupported, or unresolved (see Introduction to Manual, 0-002). When government regulations are specifically mentioned or incorporated by reference in the contract or in the terms governing submission and negotiation of the price proposal, and costs are questioned based on such regulations, the specific reference should be cited in the explanatory note describing the circumstances underlying the questioned cost. The citation should be accompanied by an appropriate explanation of the audit conclusion in terms of the reasonableness, allocability, or other factors affecting the acceptability of the cost.

b. Questioned Costs. Those amounts on which audit action has been completed and which are not considered acceptable as a contract cost will be shown as questioned costs. This category includes amounts for:

- Those items specifically identified as unallowable under the contract terms, statute, public policy, applicable government regulations, or legal advice.
- Those items which, although not specifically unallowable, are determined to be unreasonable in amount, contrary to generally accepted government accounting principles, or not properly allocable to the contract considering the relative benefit received or other equitable relationship.
- The impact on proposed costs of cost avoidance recommendations based on implementation of the cost reduction programs listed in 9-317.

- Those items questioned for other reasons, usually based on government engineering or technical advice.

(1) If part of a cost element or account is not acceptable, only that part should be questioned.

(2) If a cost element in the contractor's proposal has been significantly understated, the understated amount should be shown in the Questioned Costs column in parentheses to denote an increase for that element. If a portion of the cost element is also questioned, the net amount should be reflected. An adequate explanation should be given in all cases.

(3) Explanations regarding questioned costs should be sufficiently informative to allow the reader to fully understand the basis for the audit conclusions. The explanations should normally be shown as footnotes to exhibits and supporting schedules.

c. Unsupported Costs. Costs should be classified as unsupported when the contractor does not furnish sufficient documentation to enable a definitive conclusion. Classification of costs as unsupported is of no value to the contracting officer. Therefore, the auditor should vigorously pursue action to obtain the needed cost or pricing data (see 9-205a.). These actions must be taken promptly to avoid delays in completing the audit. Also classify as unsupported any proposed subcontract where the ACO/PCO decided to wait for the contractor completion of the required cost analysis rather than request an assist audit (see 9-104.2d.).

(1) Prompt requests for assistance to both the ACO and PCO are critical and should be confirmed in writing. The auditor should clearly identify the data needed and state how its absence would affect the overall audit opinion.

(2) When all attempts fail (including ACO and PCO assistance) to obtain the necessary supporting data, the auditor should include comments in the audit report on the action taken and classify the costs as unsupported. This should also be shown as a qualification to the scope of audit.

(3) The report should state that the contractor was advised of the unsupported costs (see 4-304.2d.). The explanatory notes for items classified as unsupported

costs will state the types of documentation considered necessary to adequately support the items and describe the auditor's efforts to obtain such documentation.

(4) Overhead and G&A expense applicable to unsupported costs should not be quantified in the Unsupported Costs column. The rates applicable to unsupported costs should be stated in the explanatory notes so that the rates can be applied to any portion of the unsupported base costs not accepted by the contracting officer to develop the corresponding amount of additional unaccepted overhead and G&A costs. When costs are classified as unsupported in subcontract audit reports, the subcontract auditor will identify the subcontractor loading factors, including profit, in the explanatory notes or by separate schedule so that they may be easily applied to the corresponding base costs in the prime contract report.

d. Unresolved Costs. Failure to receive requested DCAA assist audit reports will necessitate classifying the applicable proposed amounts as unresolved (see 9-104). The unresolved classification is also used when there are significant incomplete subcontract pricing actions applicable to repricing proposals for incentive and fixed price redeterminable contracts. Costs should not be classified as unresolved in any circumstances other than those cited in this paragraph.

(1) The guidance in 10-304.7c. on the presentation of explanatory comments on questioned costs also applies to unresolved costs. Overhead and G&A expense applicable to unresolved costs will not be quantified in the Unresolved Costs column; however, applicable rates will be provided as described in 10-304.8c.(4).

(2) The additional information or action required before a definitive conclusion can be reached on unresolved items will be stated in the footnotes or in the narrative portion of the report, together with a statement of the auditor's intentions with respect to issuance of a supplemental audit report. This statement should be based on the criteria in (3) below and on the latest information available prior to release of the initial audit report.

(3) A supplemental report should be issued when costs in this category are

resolved provided the contract negotiation has not been concluded and the report will serve a useful purpose. For example, subcontract costs may have been classified as unresolved in the audit report on the repricing of an incentive-type prime contract, pending negotiation by the contractor and subcontractor of a firm final subcontract price. In these cases, the prime contract price will usually not be finalized until a final price for the subcontract has been established. If this procedure is being followed, a supplemental report should be issued after a firm subcontract price has been established and the auditor responsible for the prime contractor has reviewed the data supporting the settlement. Any questions at that time regarding the current status of prime contract negotiations should be discussed with the contracting officer.

(4) The supplemental report need not restate the information or recommendations included in the prior report. It should be limited to unresolved items, unless their resolution affects other cost elements or a complete restatement would be more useful to the contracting officer.

10-304.9 Difference

a. A "Difference" column may be included in reports on price proposal audits. The "Difference" column is placed to the right of the last column in the "Results of Audit" group and is not a part of that group.

b. The "Difference" column is intended for the use of the contracting officer in preparing the government's negotiation objective. It should show for each cost element the arithmetic difference between the amount proposed and the sum of the related questioned, unsupported, and unresolved amounts. The amounts in this column should not be regarded or referred to as "audit approved" or "recommended" amounts. When used, the "Difference" column should be supported by an explanatory note. For example, the explanatory note might state:

"The amounts in this column are presented solely for the convenience of

the procurement activity in developing its negotiation objective. They represent only the arithmetic difference between the amounts proposed and the related questioned costs. You should not consider the amounts to be audit approved or recommended amounts. DCAA does not approve or recommend prospective costs because the amounts depend partly on factors outside the realm of accounting expertise, such as opinions on technical and production matters."

10-304.10 Additional Remarks

a. The last part in the "Results of Audit" section is reserved for additional remarks. This is an untitled section, it does not have a separate heading. In addition to the requirements related to the Results of Audit section in 10-210.5, consider the following as appropriate.

(1) If the technical evaluation discloses no exceptions to the quantitative or qualifications aspects of the proposal, include the following:

"A government technical evaluation was performed by [agency]. The technical report took no exceptions to the proposal. See Appendix _ for a copy of the technical report."

(2) If we rely on exceptions reported in the technical evaluation, the auditor should incorporate the recommendations into the audit conclusions. In such cases, include the following statement in the audit report:

"The audit conclusions incorporate the dollar effect of the recommendations contained in the [activity] technical report. See Appendix _ for a copy of the technical report."

(3) If significant estimating deficiency(ies) had been previously identified and reported, but not yet resolved, a statement such as the following may be inserted into the proposal audit report:

"We reported estimating deficiencies at PDQ Company in Audit Re-

port No. 1234-20XXA24010001, dated January 15, 20XX (Appendix #). Some of these deficiencies remain uncorrected (see the Contractor Organization and Systems section of the report on page _). The deficiencies affecting the subject proposal, and their impact, are described in the Scope of Audit paragraphs on page _ and on page _, Notes 5 and 6, of the Results of Audit.”

b. On proposals expected to result in contracts covered by DFARS clause 252.234-7001, Earned Value Management System, or DFARS clause 252.242-7005, Cost/Schedule Status Report, the auditor should provide comments on whether the contractor's Cost/Schedule Control (C/SC) system is meeting the C/SC systems criteria on other contracts and include the impact of deficiencies being reported in C/SC systems surveillance reports (9-316b.).

c. Additional Remarks. Conclude the Results of Audit section of the report narrative as discussed in 10-210.5e. Hold an exit conference with the offeror (See 10-210.5e.(1) and (2)). In the report state the date and the name and title of the offeror's designated representative with whom the factual matters were discussed. Do not disclose the dollar impact of the findings. If the report does not include an adverse opinion, include the offeror's reaction to the factual differences and the major areas of difference likely to be pursued at negotiations. An illustration of the report paragraph is shown below:

“We discussed factual matters concerning our findings with [*name and title of offeror representative*] in an exit conference held on [*date*]. We did not provide the dollar impact of our findings. [*Include a summary of the offeror's reaction and major areas likely to be pursued at negotiations.*]”

If the report includes an adverse opinion that indicates that the proposal is not acceptable as a basis for negotiation, it would be inappropriate to include the

additional remarks appearing in 10-210.5e.(1)(b) and (2)(f), regarding items to be addressed and auditor attendance at negotiations. If the proposal was evaluated at the request of the customer even though it was inadequate, tailor comments to fit the situation. For example:

“Significant findings that are contested by the contractor are discussed in the Results of Audit. We are available to provide you with assistance in resolving the reported findings. We discussed factual matters concerning our findings with [*name and title of offeror representative*] in an exit conference held on [*date*].”

d. If the report has a number of exhibits and schedules that are best presented on separate pages, it is appropriate to present your concluding remarks within the report narrative before beginning the exhibits and schedules. (See 10-304.7g.).

10-305 Report Narrative (Parts of a Proposal)

a. The guidance for a part of a proposal report applies when the auditor is asked to audit less than the complete proposal. Performance of audits by DCAA is discussed in 2-103. A part of a proposal could represent declarations regarding one or more entire cost elements (e.g., direct material, direct subcontracts and other direct costs) or portions of a cost element (e.g., direct labor rates or indirect rates). (See 9-108) The report narrative includes the same sections as discussed in 10-304. However, because we are auditing only parts of a proposal, section headings are revised to include the words “of Parts of a Proposal”.

b. In general, the wording in the individual report sections, as shown below, should be adapted to limit our report to the parts of the proposal that we were requested to audit.

c. The report on the audit of parts of a proposal includes:

- the auditor's opinion on the parts of a proposal that were audited, and
- a disclaimer of opinion on those parts that were not audited.

10-305.1 Subject of Audit of Parts of a Proposal

The subject of audit paragraph might read as follows if the audit was limited to direct material costs.

“As requested by DCMA-Alexandria, we examined the direct material cost portion (\$200,000) of ABC Company's \$800,000 firm-fixed-price proposal dated January 14, 20XX. ABC submitted the proposal for 50 widgets in response to RFP No. NA 1-101. The Company proposed a performance period of May 2, 20XX through June 30, 20XX.”

“The proposed direct material cost and related cost or pricing data are the responsibility of the contractor. Our responsibility is to express an opinion on the direct material cost based on our examination.”

10-305.2 Executive Summary of Parts of a Proposal

Because of the limited nature of audits of parts of a proposal, an Executive Summary paragraph is generally not needed. If an Executive Summary is appropriate, see 10-304.2.

10-305.3 Scope of Audit of Parts of a Proposal

a. Scope statements such as the following will be used for audits of parts of a proposal.

“As requested, we limited our audit to an examination of the proposed direct material costs. Except as discussed in the Qualifications section of the report [*omit if no Qualifications are included in the report or if the circumstances described do not have an adverse bearing on the auditor's conformance with auditing standards*], we conducted our examination in accordance with generally accepted government auditing standards. Those standards require that we plan and perform the examination

to obtain reasonable assurance about whether the parts of the proposal examined are free of material misstatement. An examination includes:

- evaluating the contractor's internal controls, assessing control risk, and determining the extent of audit testing needed based on the control risk assessment;
- examining, on a test basis, evidence supporting the amounts and disclosures for the parts of the proposal audited;
- assessing the accounting principles used and significant estimates made by the contractor in developing the proposed amounts for the parts of the proposal audited;
- evaluating the overall presentation for those parts; and
- determining the need for technical specialist assistance for the parts of the proposal audited [*and quantifying the results of a government technical evaluation*].

We evaluated the proposed direct material costs using the applicable requirements contained in the:

- Federal Acquisition Regulation (FAR)
- Defense FAR Supplement (DFARS) [*for non-DoD agencies, identify specific agency supplement - see 15-102.3*]
- Cost Accounting Standards (CAS) [*omit if the potential contract will not be CAS-covered*].”

b. The next paragraph in the Scope section of an audit of parts of a proposal should be adapted to describe that portion of the contractor's estimating system internal controls (Contractor Organization and System section) and the impact of our assessment of control risk on the scope of audit for the parts of a proposal being examined (see 10-304.3)

c. See 10-210.3 for additional statements pertaining to technical reports and contractor CAS status that should be attached to the end of the scope statements when appropriate. Also see 10-210.4 and

10-304 for a discussion of report qualifications.

10-305.4 Results of Audit of Parts of a Proposal

a. Tailor the opinion matrix at 10-304.6c for the parts of a proposal examined. It is important for you to remember to read the entire subparagraph to ensure that it is fully modified to address only the parts of a proposal examined. For example, subparagraph 10-304.6c (2), (5) and (13) limited to the audit of direct material costs could be modified to read:

“In our opinion, the cost or pricing data submitted by the offeror in support of direct material costs are inadequate in part (see Note 3 on page 7).”

“The amount proposed for direct material cost was prepared in accordance with applicable Cost Accounting Standards and appropriate provisions of FAR.”

“Because the cost or pricing inadequacies are considered insignificant, we believe that the proposed amount is an acceptable basis for negotiation of a fair and reasonable price for direct material costs.”

b. Because we have audited only parts of a proposal, we should disclaim an opinion on the proposal as a whole. This disclaimer may read:

“This report is limited to *[insert the names of the parts of a proposal examined]*. Accordingly, we express no opinion on the contractor's proposal taken as a whole.”

c. The next part of the Results of Audit section provides the details on the parts of a proposal examined and the audit results. An example follows:

“We have questioned \$35,000 of the \$200,000 proposed for the direct material costs examined.”

This summary statement may be followed with schedules showing the basis for the proposed material costs and the audit evaluation using the structured note format. Schedules and notes should address only the parts of a proposal examined.

d. Additional Remarks. See 10-304.10 for other requirements, such as documentation of the exit conference, which should be included in the report. Wording should be adjusted to reflect only the parts of the proposal examined.

e. Also see 10-210.5 and 10-210.6 for other requirements related to the Results of Audit section of the report narrative. In each case, wording should be adjusted to reflect only the specific cost elements audited.

10-306 Contractor Organization and Systems (Proposal Reports)

This section should give the reader background organization and systems information, which impacts the scope and the results of the audit. Tailor this information to the contractor's size and reference any other reports issued on the relevant systems. (See 10-210.7)

a. The “Organization” paragraph should include background information (e.g., sales information, major products and services, intercompany relationships, percentage of government business, etc.) considered pertinent to the audit and the negotiation.

b. The “Systems” paragraphs for proposal audits would usually describe the contractor's accounting and estimating internal control systems -- both of which impact the scope of pricing audits. These paragraphs would provide the following information for each system:

(1) a brief description of the system or reference to a prior audit report that provides a current description. (Provide a copy of the referenced report if it has not been previously distributed to the addressee. It can be attached as an appendix.)

(2) an opinion on the overall system [adequate, inadequate, or inadequate in part].

(3) our assessment of control risk [the designation of low, moderate or high is not required but may be used for empha-

sis if desired] and the impact of this risk on the area being audited.

(4) a list of outstanding internal control deficiencies including a brief description of each deficiency and the status of contractor corrective actions.

The impact of the control risk assessment and any outstanding deficiencies on the proposal audit would be described in the "Scope of Audit" section of the report (see 3-305.4 and 10-304.3).

c. Accounting System Internal Controls. examples of accounting system deficiencies that might impact the pricing audit include:

(1) The contractor's accounting system is not adequate to determine the costs under the type of contract awarded or anticipated to be issued.

(2) The contractor's accounting system does not provide for costing by lots, batches, or runs. As a result, learning or improvement curve techniques cannot be used to evaluate the contractor's initial pricing proposals for production contracts.

d. Estimating System Internal Controls. The sample systems section paragraphs for a contractor's estimating system (providing the information described above) might read:

"ESTIMATING SYSTEM"

"In our opinion, [*insert contractor's name*] estimating system and the related internal control policies and procedures are inadequate in part to ensure that proposals and final certified contract prices are based on accurate, complete, and current cost or pricing data. As a result of these deficiencies, the ACO disapproved the material portion of the estimating system on January 1, 20XX. Our examination of [*insert contractor's name*] estimating system is discussed in Audit Report No. 3851-XXXXL24010131, dated November 1, 20XX, previously provided to your office."

"In this examination we obtained an understanding of the estimating system internal control structure policies and procedures and determined that certain estimating methods are deficient. As a result of the following listed out-

standing estimating deficiency, we assess the risk for overestimating material costs as high and have adjusted our audit scope accordingly."

"Outstanding Estimating Deficiencies"
"Deficiency: [*insert contractor's name*] does not have effective internal controls to ensure that proposed material costs are based on current vendor quotes, recent historical prices, or reflect vendor prompt payment or quantity discounts. As a result, proposed material costs are often overstated."

"Status: [*insert contractor's name*] agrees and is currently revising its estimating policies and procedures to correct this deficiency. After the policies and procedures have been revised, training will be provided to all [*insert contractor's name*] estimators. [*Insert contractor's name*] expects to complete these actions by July 31, 20XX."

10-307 Report Distribution and Restrictions (Proposal Reports)

This section of the report will advise the recipient of report distribution and restrictions. See 10-212.1 for general information on this area.

10-307.1 Release of Audit Report to the Contractor

Reports on price proposals are not provided to the contractor unless the contracting officer directs such release in writing. See 10-212.2 for information and restrictions on releasing the report to the contractor.

10-307.2 Release of Subcontract Audit Report to the Higher-Tier Contractor

When the report is on a subcontractor's proposal to a higher-tier contractor, the report "RESTRICTIONS" must contain a statement regarding the subcontractor's agreement or objection to release of the report or information to the higher-tier contractor. See 10-212.3 for information and restrictions on releasing the subcontract audit report to the higher-tier contractor.

10-307.3 Release of Audit Report to FMS Customers

a. When the contracting officer identifies that the price proposal is for an FMS customer, the auditor should determine at the start of the audit whether the contractor objects to the release of the report to the FMS customer. The audit procedures on this matter are discussed in 9-110. The audit report "RESTRICTIONS" must contain a statement regarding the contractor's agreement or objection to release of the report or information to the FMS customer. The contractor's letter should be included as an appendix to the audit report.

b. If the contractor objects to release of the report to the FMS customer, use a statement similar to the following:

"The Defense Contract Audit Agency has no objection to release of this report, at the discretion of the contracting agency, to authorized representatives of [name of contractor] or [FMS Customer]. However, please note that [name of contractor] objects to the release of the propriety data contained in this report to [FMS customer]. See Appendix XX for a copy of the contractor's statement objecting to release of the report."

c. If the contractor does not object, the following comment should be used in the release restrictions:

"The Defense Contract Audit Agency has no objection to release of this report, at the discretion of the contracting agency, to authorized representatives of [name of contractor]. Nor does this Agency or [name of contractor] object to release of this report to authorized representatives of [FMS customer]. See Appendix XX for a copy of the contractor's release statement."

d. If the contractor does not respond to the auditor inquiry, use a statement similar to the following:

"The Defense Contract Audit Agency has no objection to release of this re-

port, at the discretion of the contracting agency, to authorized representatives of [name of contractor] or [FMS customer]. We asked [name of contractor representative and title] on [date] if [name of contractor] objected to the release of the propriety data contained in this report to [FMS customer]. As of the date of this report, we have not received a response to our inquiry."

10-308 Appendixes (Proposal Reports)

As described in the following subparagraphs, appendixes may be used to provide other information when needed. However, when you issue recurring reports to the same addressee concerning the same contractor, consider reducing the appendix material. Wherever feasible, include information in the narrative body of the report, exhibits, and/or schedules rather than in a separate appendix. For example, deficiencies in the contractor's accounting system or internal controls which are directly related to questioned cost for an element of the proposal should be explained in the applicable note rather than referring to an appendix.

10-308.1 Appendix --- Other Matters To Be Reported

a. Use this appendix, if needed, to furnish information which cannot be conveniently shown in the exhibits and schedules and to present any other financial management matters related to the proposal which should be brought to the attention of the contracting officer.

b. If the contracting officer requests specific information on the status of the contractor's systems such as purchasing system, compensation system, or automated data processing system, this information may be provided in this Appendix.

10-308.2 Appendix --- Subcontracts Requiring Contractor Cost Analyses

Use this appendix to identify subcontracts for which the contractor has not completed cost analyses required by FAR

15.404-3 (see 9-104.1). Provide this information even if assist audits have been performed or the auditor has reached a definitive conclusion by other means (e.g., applying a decrement factor or rate check). In the appendix, include the names of the subcontractors, proposed amounts, and the following explanatory note:

“FAR 15.408, Table 15-2 requires prime contractors and higher-tier subcontractors to conduct cost analysis of each subcontract proposal for which cost or pricing data are required. In coordinating the need for assist audits, we informed [*insert name(s) of ACO/PCO or representatives*] on [*insert date*] of the contractor's planned schedule for completing the cost analyses. As of [*insert date field work completed*], XYZ Corporation had not completed the required cost analyses for the subcontractors listed above. The contractor's scheduled date for completing the cost analyses is [*insert revised date(s)*]. These analyses should be submitted to the contracting officer prior to completion of prime contract negotiations.”

10-308.3 Appendix --- Incorporation of Government Technical Reports

a. See 9-103, 9-307, and Appendix D-300 for specific procedures on obtaining technical assistance/reports and for guidance on incorporating technical information/opinions into the audit conclusions and information to include in this appendix if that information cannot be effectively presented in the body of the audit report. The audit report should include an electronic or scanned version of all technical analyses received by the auditor and a quantification of the dollar effect of the technical analysis findings.

b. The report prepared by the government engineering specialist shall be used unless the findings are, in the auditor's opinion, unrealistic. The auditor shall attempt to reconcile any disagreements concerning the findings with the engineering specialist and/or the responsible supervisory personnel. Assistance to resolve the differences shall be solicited from the contracting officer, if necessary. If the auditor is unable to resolve the differences, the technical report shall not influence formation of the audit opinion or the development of the questioned cost. However, the audit report shall include the technical report as an appendix and explain why it was not used.

10-400 Section 4 --- Audit Reports on Operations and Internal Control (System Audits)

10-401 Introduction (System Reports)

a. This section provides guidance for preparing and distributing reports on

(1) audits of the economy and efficiency of contractors' operations; and

(2) internal control audits of contractor accounting and management (business) systems (see Chapter 5). Government auditing standards (see chapter 2), provide differing reporting standards for financial related and performance audits. GAGAS identifies most DCAA audits as financial related; economy and efficiency (operations) audits as performance audits; and provides listings of the types of evaluations that fit these categories. For reporting on financial related audits, GAGAS incorporates reporting standards from the AICPA's Statements on Standards for Attestation Engagements; for reporting on performance audits, GAGAS provides less detailed guidance in chapter 7 of the Yellow Book. GAGAS identifies most audits of internal controls as financial related.

(3) System audits (both operations audits and audits of internal control) address the system's adequacy to provide specific capabilities needed for contract or business purposes.

b. Reports on the results of audit of economy and efficiency of contractors' operations, and internal control audits of contractor business systems, are referred to as system reports.

c. Supplemental guidance for performing estimating system surveys is presented in 5-1213, supplemental reporting guidance for compensation audits is presented in 5-812, and supplemental reporting guidance for all internal control audits is presented in 5-110 and 5-111.

d. These audits and surveys may be initiated (1) upon request of the contracting officer, or (2) as part of the field office's responsibility for evaluating contractor systems and day-to-day operations.

e. A requestor may ask DCAA to evaluate limited portions of contractor systems by means of agreed-upon procedures. Agreed-upon procedures are appropriate when objective evaluation criteria

exist and the auditor and requestor reach mutual agreement on the procedures to be applied. Guidance in 10-1000 should be followed, modified as necessary to conform to the requirements of system reports. The auditor should ensure that:

- the acknowledgment indicates the parties have reached a clear understanding regarding the terms of the engagement (see 4-103.d.);
- the report does not refer to the engagement as an "examination" or a "review";
- the report disclaims an opinion; and
- the restrictions are appropriate for agreed-upon procedures (see 10-1008).

10-402 Nature of Reports (System Reports)

These audit reports are designed to provide an independent assessment of performance (i.e., operations audits, sometimes referred to as economy and efficiency audits) or compliance with internal control policies and procedures. The report provides an audit opinion on whether the contractor is fulfilling its responsibilities in a specific area and gives the contractor and contract administration officials information and recommendations to facilitate corrective actions and improvements.

10-403 Report Format and Contents (System Reports)

a. Consistent with the guidance in 10-200, reports will typically include the following sections:

- Cover Sheet
- Subject of Audit*
- Executive Summary
- Scope of Audit*
- Qualifications (if applicable)
- Results of Audit*
 - Opinion
 - Statement of Condition and Recommendations
 - Additional Remarks

Contractor Organization and Systems
DCAA Personnel and Report
Authorization
Audit Report Distribution and Restrictions*

Appendixes

*Section headings for real time (flash) reports differ (10-413).

b. GAGAS incorporates the AICPA's Attestation Standards (AT) chapter 5, which prohibits negative assurance on internal controls. These evaluations may be reported on only as examinations or as applications of agreed upon procedures (see 10-1000).

c. Operations audits are not subject to Attestation Standards (AT), therefore do not use the terms "examination" or "review" in the report narrative to describe the subject or purpose of audit.

d. "Shell" reports for most assignments can be found on the DCAA Intranet and the APPS.

10-404 Cover Sheet (System Reports)

a. Follow the general guidance in 10-205 and 10-206 when preparing the cover sheet. All system reports, regardless of reported conditions, internal control weaknesses, or system deficiencies, will be addressed to the principal cognizant ACO (10-206). For reports involving more than one segment of a company, this will usually be the CACO, unless the segments involved are in the same location and assigned to the same contract administration office. In such cases, the auditor should consider wider report distribution to include segment ACOs and the CACO.

b. For audits on economy and efficiency (operations audits), report distribution should also be made to those buying activities that will be materially impacted by report recommendations (both direct and indirect cost).

10-405 Subject of Audit (System Reports)

a. For reports on economy and efficiency (operations audits), this section will clearly identify the area evaluated and the objective. For example, the subject of audit paragraph may read:

"As part of our comprehensive audit of the [*insert company name*], we have evaluated the contractor's plant maintenance function, which is responsible for the maintenance and repair of equipment and buildings at the Boston facility. We performed the audit to evaluate the effectiveness of the contractor's policies and practices in assuring that maintenance tasks are carried out in a timely, efficient, and economical manner. Our audit was conducted from November 20XX through February 20XX and covered contractor operations for the fiscal year ended December 31, 20XX."

b. For audits of contractor business systems (internal controls; Chapter 5), the subject of audit paragraph may read:

"By submitting payment requests under government (*identify predominant contract type(s)*) contracts, the ABC Corporation (ABC) asserts that its internal controls are adequate to provide reasonable assurance that:

- Applicable laws and regulations are complied with;
- The accounting system and cost data are reliable;
- Risk of misallocations and mischarges are minimized; and
- Contract allocations and charges are consistent with invoice procedures.

We have examined the ABC [*insert system examined*] as of [*insert date audit fieldwork was completed*] to assure that ABC's system of [*system*] controls is adequate to provide [*system*] costs that are reasonable, compliant with applicable laws and regulations, and subject to applicable financial control systems, and (*if tests of compliance were performed*) to evaluate ABC's compliance with the system's internal control requirements."

c. This section of system reports should also include a responsibility statement. For internal control audits this may read:

"[*Insert contractor's name*] is responsible for establishing and maintaining

an adequate [insert system name] system. Our responsibility is to express an opinion on the adequacy of the [insert system name] system based on our examination.”

10-406 Executive Summary (System Reports)

This section is intended to give the reader a brief overview of the audit findings. It should briefly describe the audit recommendations and the significant issues supporting the opinion. This section of an internal control audit of the contractor's estimating system may read:

“The contractor's estimating system is inadequate in part. Our examination disclosed two significant deficiencies in [insert contractor's name] estimating system that result in overstated and unsupported material and subcontract costs. As a result, we recommend disapproval of these portions of [insert contractor's name] estimating system.

SIGNIFICANT ISSUES

- [Insert contractor's name] does not prepare a consolidated bill of material to support proposed material costs. This deficiency results in overstated material costs since vendor quantity discounts are often not considered when pricing material quantities.
- [Insert contractor's name] does not analyze subcontractor proposals prior to negotiating the prime contract price. This deficiency results in substantial overstated proposed subcontract costs since [insert contractor's name] achieves reductions in the subcontractor's proposals after the analysis have been performed.
- [Insert contractor's name] agrees and is taking aggressive action to correct these deficiencies.”

10-407 Scope of Audit (System Reports)

a. Develop an appropriate scope of audit statement. The scope elements will differ

based on the type of system audit performed. For example:

(1) For operations audits (section 14-500), the scope of audit may read:

“Except for the qualifications discussed below (*omit if there is no “Qualifications” section within the “Scope” paragraph*), we conducted our audit in accordance with generally accepted government auditing standards. Those standards require that we plan and perform the audit to:

- obtain an understanding of the area to be audited,
- consider legal and regulatory requirements,
- identify and review management controls applicable to the area,
- identify criteria needed to evaluate matters subject to audit,
- identify and examine relevant sources of data to satisfy the audit objectives,
- determine the need for technical specialist assistance, and
- identify significant findings and recommendations from previous audits that could affect the audit objectives, and determine if the contractor has corrected the conditions leading to those recommendations.”

(2) For internal control audits of contractor business systems (Chapter 5), the scope of audit may read:

“Except for the qualifications discussed below (*omit if there is no “Qualifications” section within the “Scope” paragraph*) we conducted our examination in accordance with generally accepted government auditing standards. Those standards require that we obtain a sufficient understanding of internal controls to plan financial audits and determine the nature, timing and extent of tests to be performed. An examination of internal controls includes:

- identifying relevant system control objectives and associated control activities,
- obtaining an understanding of all applicable components of internal

control for the identified control objectives and activities,

- determining if the internal controls are adequate and in operation, and
- assessing control risk to use as a basis for planning the nature, timing and extent of substantive testing in other financial related audits.”

(3) If an audit combines an evaluation of the economy and efficiency (operations) aspects of a system with the applicable internal controls, the scope of audit should cover both the operations and the internal control aspects. The auditor should draft an appropriate scope paragraph combining relevant aspects of the guidance in 10-407a.(1) and (2) above.

b. The next scope paragraph, regardless of the type of system audit performed, should identify the established or stated criteria used to evaluate the area:

“We evaluated the *[insert data, records, representations or system name]* using the applicable requirements contained in the: *[list only applicable references]*

- Federal Acquisition Regulation (FAR);
- Defense FAR Supplement (DFARS);
- Cost Accounting Standards (CAS); and
- Industry or Technical Guides.” *[Identify]*

c. The types of contractor records and documents examined should be briefly identified along with a description of unique audit steps or techniques used and the period of performance for the audit fieldwork. Internal control audits should describe the scope of the auditor's work in obtaining an understanding and testing relevant internal control objectives. For example, this paragraph may read:

“Our examination specifically tested the *[insert system name]* system's internal control procedures associated with the following control objectives: *[List the system's control objectives from Chapter 5.]* Test procedures were applied

from *field work starting date* to *field work completion date.*”

d. Provide a statement which informs the reader that the audit provides a reasonable basis for the audit opinion, e.g., “We believe that our examination provides a reasonable basis for our opinion.”

e. Any external factors that restricted or limited the scope of the audit should be clearly described within the scope of audit section under a separate heading entitled “Qualifications” (See 10-210.4). Internal decisions to limit the audit scope are not “qualifications.” When necessary to avoid user misunderstanding, scope limitations should be briefly described within the scope of audit section.

f. Conclude the Scope section of an internal control audit with the Inherent Limitations paragraph:

“Because of inherent limitations in any internal control, misstatements due to error or fraud may occur and not be detected. Also, projections of any evaluation of the internal control over *[subject area]* to future periods are subject to the risk that the internal control may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.”

10-408 Results of Audit (System Reports)

The Results of Audit section should summarize the conditions and recommendations found during the system audit. The opening paragraphs will vary according to the nature of the report.

10-408.1 Economy and Efficiency Audits (System Audits)

a. Audits that identify opportunities for improved practices resulting in potential cost avoidance should include in the audit opinion a summary description of the recommendation, acknowledgment of the contractor's initiatives (if applicable), and the estimate of potential cost avoidance in the opening paragraph. For example, the statement might read:

"In our opinion, cost savings could be realized through the implementation of interactive computer graphic techniques (ICGT). The contractor has taken the initiative to assure employees have a high level of computer capability. However, the audit disclosed that the use of ICGT can greatly reduce processing time and associated labor costs related to current manual methods used for preparing layouts, schematics, and drawings. It is estimated that annual cost avoidance of \$1.1 million can be realized through the implementation of ICGT. Approximately \$0.6 million of the total \$1.1 million is allocable to government contracts."

b. Follow this statement by briefly describing the conditions that create the opportunity for the estimated cost avoidance, including the amount applicable to each condition, and a concise explanation of how adopting the recommendation will result in savings. Acknowledge contractor actions that have achieved savings in the area under evaluation. These conditions should be detailed as "Statements of Condition and Recommendations" (see 10-409) and may be contained in the Results of Audit section of the report. If sufficiently complex as to warrant separate pages, a reference may be included here and the details contained in the report as a "STATEMENT" (see APPS "shell" reports for details).

c. A paragraph concerning the incorporation of the audit's cost avoidance recommendations into price proposals, with respect to the appropriate time periods, should be included in this section. An explanation of the impact of the audit's recommendations in the incurred cost rates may also be included to provide added information to the reader. For example, the statement might read:

"The audit results pertain to the reasonableness of the contractor's future costs. Therefore, we recommend that the contracting officer instruct the contractor to incorporate the effects of the recommendations into its estimating methods, forward pricing rate schedules, and ap-

plicable contract price proposals. In our opinion, the audit recommendations can be implemented as early as [*specify quarter and year*] and impact the [*specify cost area(s), such as general and administrative expense rate, direct engineering design labor cost, and manufacturing overhead rate*]. As the audit recommendations are implemented, the incurred cost rates should reflect their impact. Consequently, forward pricing estimates based on historical cost will also reflect cost savings. Accordingly, swift action to implement the audit recommendations can assure timely cost savings. In the event that cost-saving actions are not initiated within a reasonable time period, we will question the costs as being unreasonable in accordance with FAR 31.201-3. We may also recommend that the contracting officer adjust future pricing proposals to reflect the effects of identified inefficient or uneconomical practices."

d. If significant internal control deficiencies are noted during an operations audit, the scope of audit section should identify the deficiencies and state the potential cost impact or the general effect and risk to the government associated with these deficiencies. State that we will initiate a separate internal control audit of the applicable system and issue a separate report. Refer to 10-408.2 below.

e. Conclude the Results of Audit section of the report narrative with the following additional remarks, as appropriate:

(1) Exit Conference

(a) In all evaluations, state the date held and the name and title of the contractor's designated representative with whom factual matters were discussed (see 4-304). The summary might read as follows:

"We discussed the results of audit with [*Name and Title of contractor representative*] in an exit conference held on [*date*]."

(b) If there are findings, such as non-compliances, system deficiencies, cost avoidances, or cost impacts, in addition to the requirement of step 10-408.1e.(1)(a) above, summarize the contractor's reaction

to factual differences, the major areas of difference likely to be pursued at negotiations, and any other comments relevant to resolution of the findings.

(c) If the engagement is an evaluation which requires that a Statement of Conditions and Recommendations be furnished to the contractor, include the following statement:

"We provided a draft copy of [*the "Results of Audit" and "Statement of Condition(s) and Recommendation(s)"*] to the contractor's representative at the exit conference."

(d) When the contractor provides a formal, written response, it should be referenced within the Results of Audit section and included as an appendix to the report. Put any rebuttals in the "Auditor's Response" portion of the explanatory notes. Include the following statement:

"The complete text of the contractor's response appears as Appendix [x]."

(2) Use the guidelines provided in 10-210.5e.(2) to prepare other additional remarks.

f. This section should also report the status of contractor efforts to correct previously reported conditions in the same area and should state whether the auditor considers the corrective action adequate. If corrective action has not been taken or is inadequate, the recommendation should be restated and the updated discussion of the matter should be referenced in the present report.

g. In operations audits, usually parts of the contractor's operating systems are audited rather than the entire system. As a result, the Results of Audit section should generally include the following paragraph:

"We evaluated only the [*identify the operating system audited*]. Accordingly, we express no opinion on the contractor's operating systems taken as a whole."

h. In an operations audit, the objective is to persuade the contractor to adopt the audit findings. Accordingly

the presentation of the findings at the exit conference and the contractor's comments are vital elements of the audit report.

i. In those cases where an operations audit report recommendation will materially impact either existing program cost, or any prospective pricing of related programs, that audit report should, at a minimum, provide a listing of those programs and a copy distributed to the buying activity (see 10-404b.).

10-408.2 Internal Control Audits (System Audits)

a. General. Evaluations of internal controls express an overall opinion on the adequacy [i.e., adequate, inadequate in part or inadequate] of those aspects of the accounting and management (business) system and related internal controls that were examined. For example, the Results of Audit paragraph may read:

"In our opinion, the [*indicate the system audited*] system and related internal control policies and procedures of [*insert contractor's name*] are adequate [*or inadequate*] [*or inadequate in part*]."

- If no deficiencies are found, the system should be reported as adequate.
- If deficiencies are found that the contractor has already corrected, the system should be reported as adequate after the changes have been verified.
- If conditions are found that do not materially affect the adequacy of the system, but the system would be enhanced if they were corrected, they should be reported as "Suggestions to Improve the System" (see c. below). These conditions should not be reported as deficiencies.
- If significant deficiencies are observed, the opinion on the system should be either "inadequate in part" or "inadequate."

(1) If deficiencies are found that affect only parts of the system, the audit opinion should state that the system is inadequate in part and identify the inadequate portions of the system.

(2) If the deficiencies are so significant that the entire system is unreliable, the audit opinion should state that the system is inadequate.

(3) When significant deficiencies are found and the contractor has proposed or is in the process of taking appropriate corrective actions, the actions should be described in this report section. However, the existence of a corrective action plan will not make an inadequate system reliable. The auditor should not report a contractor's system as "adequate" based on the contractor's corrective action plan, i.e., the auditor must first verify the contractor's implementation of the action plan correcting the deficiencies. A follow up audit should be performed as soon as possible to verify that the contractor's plan has been implemented.

b. If our audit disclosed significant deficiencies, the results of audit should identify the deficiencies and the affected costs. This paragraph should also provide the estimate of costs affected by the deficiency (i.e., direct cost and related indirect expense). For example, if the deficiencies result in unallowable costs being charged to the government, the estimated amount of unallowables would be disclosed. If the unallowable amount is indeterminable, the costs generated by the deficient system (or portion of the system) would be disclosed (e.g., if labor transfer documentation was deficient, the cost related to the labor transfers would be disclosed). The deficiencies and the related cost impacts should be summarized here and detailed in the "Statement of Condition and Recommendations" section below or may be separately identified in the "STATEMENT" portion of the report (see 10-409). For example, this paragraph may read:

"Our examination noted certain significant deficiencies in the design or operation of the internal control structure. In our judgment, these deficiencies could adversely affect the organization's ability to record, process, summarize, and report [*indicate the nature of costs associated with the system(s) audited, e.g., labor incurred costs*] in a manner that is consistent with applicable government

contract laws and regulations. These conditions are detailed in the "Statement of Condition and Recommendations" on page [xx] and summarized below:"

c. If the auditor identified deficiencies that are not considered to be significant, but correction would enhance the system, they should be reported in an appendix entitled "Suggestions to Improve the System." For example, this paragraph may read:

". . . During the course of our examination, we also noted other matters involving the [*indicate system being audited*] system and related internal controls which, although not considered to be significant deficiencies at this time, we believe should be communicated to the management of [*insert contractor's name*]. These matters are detailed in the "Suggestions to Improve the System" appendix included on page [xx] of this report."

d. Report the impact that control risk assessments will have on the nature and extent of audit effort on other financial related audits. For example, this paragraph may read:

"As a result of control risk assessments, our audit effort in the following areas will be [*increased/ decreased*]:

[*List the audit areas affected and the changes in audit effort*]."

e. If significant deficiencies are reported for systems where FAR/DFARS provides for approval/disapproval (i.e., estimating and purchasing) and the deficiencies have not been corrected, recommend disapproval of the identified part or the entire system. For all systems, if the contractor has not taken positive actions on the deficiencies, recommend other government actions such as suspension or disapproval of costs generated by the inadequate portion of the system or the entire system.

f. Many major government contracts contain clauses requiring an approved Earned Value Management System (EVMS)

meeting criteria set forth in DoD 5000.2-R for performance measurement on selected acquisitions (11-200). If the contractor has contracts requiring an approved EVMS, provide an assessment of whether the deficiencies disclosed in the report are likely to materially affect the reliability of the contractor's EVMS. Discuss findings and recommendations relating to the EVMS with the Contract Administration Office EVMS monitor and the audit supervisor prior to issuance of the report. Immediately after issuing the report, the auditor should evaluate the impact of these deficiencies on specific contracts requiring an approved EVMS and where significant provide the details in EVMS surveillance reports (11-209.2e.). For example, the systems report might say:

"We believe the deficiencies noted in this report will have a material impact on the reliability of the contractor's Earned Value Management System (EVMS) and on the accuracy of the system's data. Immediately after issuing this report, we will evaluate these deficiencies to determine the impact on specific contracts requiring an approved EVMS and will provide the details in EVMS surveillance reports."

g. Conclude the Results of Audit section of the report narrative with the following additional remarks, as appropriate:

(1) Exit Conference

(a) In all evaluations, state the date held and the name and title of the contractor's designated representative with whom factual matters were discussed (see 4-304). The summary might read as follows:

"We discussed the results of [audit, procedures, etc.] with [name and title of contractor representative] in an exit conference held on [date]."

(b) If there are findings, such as non-compliances, system deficiencies, or cost impacts, in addition to the requirement of step g. (1) (a) above, summarize the contractor's reaction to factual differences, the major areas of difference likely to be pursued at negotiations, and any other comments relevant to resolution of the findings.

(c) If the engagement is an evaluation which requires that a Statement of Conditions and Recommendations be furnished to the contractor, include the following statement:

"We provided a draft copy of [*the Results of Audit*" and "*Statement of Condition and Recommendation*"] to the contractor's representative at the exit conference."

(d) When the contractor provides a formal, written response, it should be referenced within the Results of Audit section and included as an appendix to the report. Put any rebuttals in the "Auditor's Response" portion of the explanatory notes. Include the following statement:

"The complete text of the contractor's response appears as Appendix [x]."

(2) Use the guidelines provided in 10-210.5e.(2) to prepare other additional remarks.

h. This section should also report the status of contractor efforts to correct previously reported conditions in the same area and it should state whether the auditor considers the corrective action adequate. If corrective action has not been taken or is inadequate, the recommendation should be restated and the updated discussion of the matter should be referenced in the present report.

i. Business systems audits usually audit parts of the contractor's system of internal controls rather than the entire system. As a result, the results of audit section should generally include the following paragraph:

"We examined only the [*insert the business system audited*]. Accordingly, we express no opinion on the contractor's system of internal controls taken as a whole."

10-409 Statement of Condition and Recommendations (System Reports)

a. The statements of condition and recommendations are an integral part of the results of audit and should follow the narrative described in 10-408. Alternatively, they

may be included in attached appendixes. The presentation should follow the six-element outline as noted below to present a logical statement of conditions and recommendations. The two main subheadings should be "Condition" and "Recommendation". Although the six elements of an audit finding should not be addressed under separate subheadings, they must be included as part of the statement of condition to present a logical, convincing case.

(1) Condition - This attribute identifies the nature of the deficiency, finding, or unsatisfactory condition by disclosing how things are.

(2) Criterion - This attribute establishes the legitimacy of the finding disclosing how things should be.

(3) Cause - This attribute gets to the root of the problem by answering the question, "Why did it happen?"

(4) Fact - Examples should be included to demonstrate to the contracting officials and contractor that the reported conditions do exist.

(5) Effect - This attribute convinces the reader that the condition is significant by answering the question, "What happened as a result of this condition? How was the government harmed?"

(6) Recommendation - This attribute suggests remedial action answering the question, "What must be done to eliminate the cause of the condition?" If the relationship between the cause and the condition is clear and logical, the recommended action(s) will most likely be feasible and appropriately directed.

b. Present a comprehensive condition statement for each significant deficiency or area susceptible to improvements in economy or efficiency. In operations audit reports quantify the estimated annual savings to be realized by implementing the audit recommendation(s) to eliminate the deficiency. If estimated annual savings is not relevant, provide an estimate of the costs affected by the deficiency.

c. The auditor's constructive, specific recommendation(s) should be stated immediately after each reported condition. Use a separate section labeled "Contractor's Reaction" to summarize the contractor's response to the condition and recommendation(s). Include the complete

written response as an "appendix." If the contractor's comments warrant a rebuttal or rejoinder, include DCAA's argument in a section labeled "Auditor's Comments."

10-410 Contractor Organization and Systems (System Reports)

This section should furnish pertinent information necessary for the reader to understand the area audited. This information should be classified under separate subheadings for the organization and individual system(s) (e.g., accounting system, estimating system, labor system, etc.) If this information has previously been provided to the report recipient, it should be referenced here.

a. The "Organization" paragraph might include a description of contractor's organization, intercompany relationships, facilities, product lines and current operations, staffing levels, percentage of government participation and so forth.

b. The "Systems" paragraphs for individual audits of business internal control systems should provide background on the system being audited. For example, background on the estimating system may read:

"ESTIMATING SYSTEM"

"[insert contractor's name] has about 30 employees who work in the Estimating Department. The Estimating Department is responsible for preparing cost estimates used in individual price proposals, indirect expense rate forecasts, indirect departmental cost budgets, progress payment requests, and contract financial reports. [insert contractor's name] detailed estimating policies and procedures are described in its "Consolidated Estimating Manual." The last revision made to this manual was dated July 31, 20XX.

During the last FY 20XX, [insert contractor's name] submitted about \$750 million of price proposals to the government. Based on these proposals, [insert contractor's name] expects to obtain contract awards of about \$420 million."

c. The information in our internal control audits (and related ICAPS -- see 3-300) provides the basis for planning the scope of other financial related audits (e.g., proposal, incurred cost, progress payment, etc. see 10-210.7). The "Systems" paragraphs in other financial related audits would provide the following information:

(1) a brief description of the system or a reference to the internal control audit report for the system.

(2) an opinion on the overall system [adequate, inadequate, or inadequate in part].

(3) our assessment of control risk for outstanding deficiencies.

(4) a list of outstanding internal control deficiencies including a brief description of each deficiency and the status of contractor corrective actions.

d. The impact of individual control risk assessments and any outstanding deficiencies on other financial audits would be described in the "Scope of Audit" section of the report (see 3-305.4 and 10-304.3).

e. The cost impact of these deficiencies would be shown in the "Results of Audit", and the "Contractor Organization and Systems" section would be updated to reflect:

- the current status of corrective action (see 10-210.7 and 10-306), and
- new deficiencies observed during this audit (see 10-413).

10-411 DCAA Personnel (System Reports)

a. Identify the contacts (e.g., the auditor, supervisory auditor and FAO manager) for further information regarding the audit. See Figure 10-2-3 for an example of the information that should be provided in this section.

b. "Audit Report Authorized By" is the signature block for the audit report. Show the signature authentication prescribed in 10-211.

10-412 Distribution and Restrictions (System Reports)

a. All recipients of the audit report will be identified in this section of the report.

Section 10-212 delineates the basic policy and instructions on distributing audit reports. In addition, report copies should be distributed as specified below to provide information that other officials may use in performing their respective duties. Audit report distribution requirements for non-DoD contractors are shown in Supplement 15-1S6. Non-DoD address lists for audit reports are presented in Supplements 15-1S1 through 15-1S5. Refer back to 10-404b. for other considerations.

b. Audit report distribution restrictions should be listed in this section of the report. Follow the general guidance in 10-212 and figure 10-2-4.

10-412.1 Distribution to Contractor

a. The ACO is responsible for formally notifying the contractor of the reported results of audit by forwarding the report to the contractor.

b. Show the contractor on the report distribution list (10-212), using the parenthetical phrase "(thru the ACO)."

10-412.2 Distribution to Other In-Plant Government Representatives

Other government procurement activities have resident offices at some contractor facilities. They may include technical staff from the program office, requirements analysts from the logistics support office, and procuring contracting officers' representatives. Provide each such office a copy of any report, which affects its area of the contractor's operation unless the office prefers not to receive such reports.

10-412.3 Distribution to Procurement Offices

a. Information copies of reports with significant findings should be sent to each procurement office doing substantial business with the contractor, unless an office's contracts would not be affected by the reported conditions. A report with significant findings is one that discloses one or more major deficiencies or recommends significant cost avoidance or contractor corrective action(s). A follow-up report should be distributed as a significant report if the

prior report on the same subject contained significant findings.

b. Upon written request to the FAO, a procurement office may be added to or deleted from report distribution lists for a particular contractor without regard to the above criteria.

c. For distribution procedures related to team reports see 10-206.1.

10-412.4 Additional Distribution of Reports on Subcontractors

a. Some companies perform significant subcontracts under major procurement programs. In such cases report distribution should consider the information needs of the procurement office(s) involved. Apply the same criteria as for prime contractors (10-412.3 above). A report distributed to a procurement office because of subcontract rather than prime contract interest requires further distribution to each plant representative/ACO at the related prime contractor and any intervening subcontractors.

b. When distribution to a procurement office is not warranted, consider whether the reported conditions may nevertheless be significant to the plant representative/ACO at the next higher-tier contractor doing substantial business with the subcontractor. An estimating system survey of a subcontractor (if significant deficiencies are involved) is an example of a report that would normally be of interest to government representatives at the next higher tier. Such reports are not intended for action by or release to the higher-tier contractors. Therefore, the cover sheet stipulation concerning release of subcontractor information (10-212.3) is not required. If a higher-tier plant representative/ACO or auditor believes that the contractor should be advised of a particular condition at the subcontractor, an assist audit request should be processed so that an appropriate report may be prepared for the contractor's use.

10-412.5 Distribution to Other DCAA Offices

For each higher-tier plant representative/ACO included on the distribution list for a report on a subcontractor, also dis-

tribute a copy to the auditor at the higher-tier contractor.

10-412.6 Additional Distribution---NASA Contractors

a. If NASA contracts are subject to the system audit, one copy of the report should be sent to each of the NASA procurement centers that have current significant contracts with the subject contractor. See 15-1S2 for a listing of centers, which can be identified to the contractor's workload through the NASA contract code for each center. Major subcontract workload under NASA programs should also be considered (see 10-412.4).

b. If requested, a copy should be sent to the Inspector General's Office, Assistant IG for Auditing. (see 15-1S1). Provide additional distribution if requested by NASA officials. (Also see 15-106.)

10-413 Real Time Reporting (Flash Reports)

When an internal control deficiency is observed during other financial related audits, the auditor should immediately draft a flash internal control report and submit it to the contractor for comment. The purpose of the flash report is to get the resolution process started -- do not wait until the related audit is completed to issue the flash report. The flash report should be addressed to the principal cognizant ACO (10-404) and additionally, to the PCO (9-310) when reporting cost estimating deficiencies in cost estimates. The major sections for a flash report are discussed below.

10-413.1 Subject of Evaluation

This section should describe our continuing assessment of the contractor's internal control structure during related audits. The following statement would be appropriate for an estimating system deficiency disclosed during a price proposal audit:

"Our price proposal audits include determining if the contractor consistently

complies with established estimating system internal controls for developing accurate, current and complete cost estimates. Consistent application of sound estimating procedures should reduce instances of defective pricing and facilitate audit and evaluation of the contractor's proposals submitted in connection with government procurement actions."

10-413.2 Scope of Evaluation

Briefly describe the procedures used to identify the internal control deficiency(ies) and explain that the evaluation was limited to contractor practices associated with a perceived internal control deficiency in one or more of the contractor's business systems. The following statement might be appropriate when an estimating deficiency is encountered during a price proposal audit:

"Our evaluation was limited to certain contractor estimating practices used in preparing its proposal submitted in connection with RFP/RFQ No. __. We did not perform sufficient audit procedures to constitute an examination of all applicable estimating system internal controls in accordance with generally accepted government auditing standards."

10-413.3 Results of Evaluation

This section should focus on the observed deficiency(ies). The following statements might be appropriate when an estimating system deficiency is encountered during a price proposal audit:

"Certain contractor estimating practices used in preparing its proposal(s) submitted in connection with RFP/RFQ No. __ [parenthetically reference the audit report where the deficiency(ies) was/were found] require corrective action to improve the reliability of its future cost estimates."

a. The auditor should follow the opening statement with a separate condition and recommendation statement for each cited deficiency. This section should identify the audit area affected, the projected cost impact, and

the additional audit procedures needed to protect the government because of this deficiency. Consider the general guidance in 10-409 and the information presented below:

(1) Condition. Describe each deficiency in sufficient detail to provide a thorough understanding of the situation.

(2) Cost and Audit Impact. Explain the significance of the deficiency, i.e., the cost impact on the current price proposal and the additional audit procedures needed on subsequent proposals until the deficiency is resolved.

(3) Recommendation. We may offer specific recommendation(s) for corrective action, but, in most cases, we would recommend that the contractor review the cited deficiency to determine if it is a systemic problem needing corrective action.

(4) Contractor's Reaction. Disclose any oral or written contractor reaction to the issue presented.

(5) Auditor's Comments. Offer any rejoinder to the contractor's reaction and response. [If there are a number of deficiencies, move the condition and recommendation statements to the end of the Results section and begin each on a separate page.]

b. The auditor should disclaim an opinion on the overall adequacy of the related system because the procedures necessary to express an opinion are normally not performed in other related financial audits. These procedures are normally performed as part of the cyclical audit of each applicable contractor accounting and management internal control system. For smaller non-major contractors, such procedures may be performed in appropriately scoped system audits, the annual incurred cost audit, or other scheduled audits (5-111.3). An example of this disclaimer follows:

"This report is limited to the cited deficiency(ies). Accordingly, we express no opinion on the adequacy of the contractor's estimating system internal controls taken as a whole."

c. The next paragraph should state that we will initiate a separate internal control examination of the related system and issue a separate report as soon as possible (preferably within 90 days). For smaller non-

major contractors, refer to the audit where the follow-up steps will be performed. A statement similar to the following would be appropriate for a flash report on estimating system deficiencies:

“Within approximately three months [*or other appropriate time period*] we will perform a follow-up audit on the contractor's estimating system internal controls to determine the status of the cited deficiency(ies), the status of contractor corrective action(s), and the impact of the deficiencies on the overall adequacy of the contractor's estimating system internal controls taken as a whole.”

10-413.4 Contractor Organization and System Section

The flash report updates the Contractor Organization and System section included in other related audits. Add the new deficiency to the existing list of any outstanding deficiencies. Briefly describe the deficiency, its impact on other related audits, and the status of contractor corrective action (see 10-210.7 and 10-410).

10-413.5 Impact on Other Related Audits

a. To ensure consideration of the observed deficiency in other related audits during the resolution process, the auditor should appropriately note/reference the deficiency on the applicable Internal Control Audit Planning Summary (ICAPS) form or Internal Control Questionnaire (ICQ) form for smaller non-major contractors. However, do not revise the overall system opinion in section III of the ICAPS form until a system audit or follow-up system audit has been performed and an audit opinion (versus disclaimer) reported (see 3-306a.).

b. In other related audit reports, such as a pricing proposal, the auditor would describe the impact, if determinable, of the observed internal control deficiency in the scope and the results of audit sections. The auditor would also list the deficiency and the status of contractor corrective action in the Contractor Organization and Systems section, until the deficiency is corrected.

10-500 Section 5 --- Audit Reports on Annual Incurred Costs

10-501 Introduction (Incurred Cost Reports)

a. This section presents guidance for preparing and distributing audit reports on final contracting officer determined (FAR 42.705-1) and final audit-determined (FAR 42.705-2) indirect cost rates. Guidance on reporting on a desk review of a low-risk incurred cost submission (6-104.5) appears in 10-506.

b. Results of the concurrent audit of proposed direct costs will be reported in the audit report on annual indirect costs. Guidance on assist reports to other contract auditors is in 6-800.

c. Keep the ACO informed of significant issues, which may ultimately require his or her action to resolve. If the contractor does not concur in the audit-determined rates, follow the procedures in 6-900 and prepare the audit report only after having coordinated with the ACO to ensure consideration of all information bearing on the area of nonconcurrence. If it appears that the contractor will not agree with the findings, provide the ACO with written documentation of the results of audit, which will be communicated, to the contractor, at the final exit conference. In addition, provide the ACO with a copy of the contractor's written rebuttal to the audit findings immediately upon receipt.

d. A requestor (or other DCAA office) may ask for an evaluation of limited aspects of (sub)contractor cost claims by means of agreed-upon procedures. Agreed-upon procedures are appropriate when objective evaluation criteria exist and the (sub)contract auditor and requestor reach mutual agreement on the procedures to be applied. Guidance in 10-1000 should be followed, modified as necessary to conform to the requirements of (sub)contract incurred costs. The auditor should ensure that:

- the acknowledgment indicates the parties have reached a clear understanding regarding the terms of the engagement (see 4-103.d.);
- the report does not refer to the engagement as an "audit";
- the report disclaims an opinion; and

- the restrictions are appropriate for agreed-upon procedures (see 10-1008).

10-502 Nature of Reports (Incurred Cost Reports)

a. Audit reports on indirect costs are designed to furnish audit information and recommendations on the allowability of costs and rates for settlement purposes and to provide support for establishment of final indirect cost rates. In order to initiate the waiting period for the contractor's response, all audit findings applicable to a fiscal period must be summarized in a single audit report. This does not preclude issuance of reports on significant system deficiencies, CAS/FAR non-compliances, or reports required to support timely issuance of DCAA Forms 1 (see 6-900). Also, the auditor should be discussing significant audit findings with the contractor during the audit to expedite the resolution process. Multi-year audit reports must clearly segregate all findings by fiscal period.

b. When direct costs are audited concurrently with the indirect costs, any questioned or disallowed direct costs will be included in the audit report. However, such reporting does not replace the issuance of the following:

(1) Notices of Costs Suspended and/or Disapproved (6-900).

(2) Audit reports on individual FPR/FPI price redetermination proposals (10-900).

(3) Final audit reports on individual cost-reimbursement type contracts and subcontracts (10-900).

(4) Interim assist audit reports to the upper-tier auditor when needed (6-800).

c. The audit report cannot be issued before the required field work has been completed and the final exit conference has been held. Required field work includes audit procedures and tests judged necessary by the auditors, and prescribed by generally accepted government auditing standards and MAARs. Therefore, the audit report will not, as a rule, contain qualified opinions or unresolved costs (see 10-504. 3 for comments on scope).

**10-503 Report Format and Content
(Incurred Cost Reports)**

a. Prepare the report in the format given in 10-200. It should be addressed to the contracting officer, and should include the information required by FAR 42.705-1(b)(2). The extent of detail to be included in the report exhibits and schedules should be governed by the materiality of the indirect cost pools, the government's participation, and the amount of questioned costs. A "shell" report for nonmajor contractors is provided on the DCAA Intranet and the APPS.

b. In the case of audit determined indirect rates, if the audit of the contractor's proposal discloses insignificant unallowable costs subject to penalty (6-609), the information normally included in the explanatory notes for each cost element as described in 10-504.5d.(3) does not need to be provided, as long as this is agreeable to the contracting officer. In cases where the audit resulted in unallowable costs subject to penalty and for procurement determined indirect rates, include sufficient indirect cost and rate data and explanatory notes for each account/element with questioned costs as described in 10-504.5d.(3) to provide the reader with an understanding of how the audit results were achieved. Including such data should also enable the negotiator to prepare the negotiation report when required.

c. Ensure that the audit report is issued within 60 days from the date the contractor's rebuttal comments are received. This should provide more than ample time since all significant issues should be discussed with the contractor on a real time basis. Enclose copies of applicable DCAA Forms 1 with the audit report and include a specific reference to the attached DCAA Forms 1 in the narrative body of the report.

d. In keeping with the guidance in 10-200, the report will consist of a cover sheet, narrative section including, exhibits and schedules, and appendixes assembled in the following sequence:

- Cover Sheet
- Report Narrative
- Subject of Audit*
- Executive Summary
- Scope of Audit*

- Qualifications (if applicable)
- Results of Audit*
- Exhibits and Schedules
- Indirect Costs
- Direct Costs Questioned (if applicable)
- Indirect Costs Subject to Penalty
- Exhibit of Contracts (with annotations to those contracts that include the penalty clause.)
- Schedule Listing Allowable Costs by Contract
- Contractor Organization and Systems
- DCAA Personnel and Report Authorization
- Audit Report Distribution and Restrictions
- Appendixes (as applicable)
 - Other Matters to be Reported
 - Billing Rates
 - DCAA Forms 1
 - Indirect Cost Rate Agreement
 - Certificate of Final Indirect Costs
 - Assist Audit Reports
 - Contractor's Response

*Refer to 10-506 for reporting on Reviews of Low-Risk Incurred Cost Submissions

10-504 Report Narrative (Incurred Cost Reports)**10-504.1 Subject of Audit**

This section should identify the period audited and the purpose of the audit.

Example 1 (Final Contracting Officer Determined Indirect Cost Rates):

"We examined the XYZ Company's January 2, 20XX certified final indirect cost rate proposal and related books and records for reimbursement of FY 20XX incurred costs. The purpose of the examination was to determine allowability and allocability of direct and indirect costs and recommend Contracting Officer determined indirect cost rates for October 1, 199X through September 30, 20XX. The proposed rates apply primarily to the flexibly-priced contracts listed in Exhibit D, page 20. A copy of XYZ's Certificate of Final Indirect Costs, dated January 2, 20XX, is in-

cluded as Appendix 1 to the report (see page 26).”

“The proposal is the responsibility of the contractor. Our responsibility is to express an opinion based on our examination.”

Example 2 (Final Audit-determined Indirect Cost Rates):

“We examined the XYZ Company's January 2, 20XX certified final indirect cost rate proposal and related books and records for reimbursement of FY 20XX incurred costs. The purpose of the examination was to determine the allowability and allocability of direct and indirect costs and establish audit determined indirect cost rates for October 1, 199X through September 30, 20XX. The proposed rates apply primarily to the flexibly-priced contracts listed in Exhibit D, page 20. A copy of XYZ's Certificate of Final Indirect Costs, dated January 2, 20XX, is included as Appendix 1 to the report (see page 26).”

“The proposal is the responsibility of the contractor. Our responsibility is to express an opinion based on our examination.”

10-504.2 Executive Summary

This section gives the reader a brief overview of the audit findings. It briefly describes the audit recommendations, and the significant issues supporting the opinion. This section can be omitted in reports where the Results of Audit sufficiently summarizes the audit findings. An example of an Executive Summary is shown in Figure 10-2-2.

10-504.3 Scope of Audit

a. Use this section to detail the scope of the audit or any scope limitations. The standard scope of audit statement is discussed in 10-210.3. The scope of audit should briefly describe the status of the contractor's accounting system for the fiscal year under audit, and the most ap-

plicable management systems which were used to control and account for the recording of costs (e.g., Indirect and ODC system). The scope paragraph should also provide the impact the auditor's assessment of control risk had on the scope of audit and the impact of any outstanding system deficiencies on the incurred cost audit. Additional detail should be provided in the Contractor Organization and Systems section of the report.

(1) An example paragraph where the contractor's accounting system has been audited and deemed adequate might read:

“For 20XX [*the fiscal year(s) under audit*], we considered XYZ's accounting system to be adequate for the accumulation, reporting, and billing of costs on government contracts, as described in the Contractor Organization and Systems section of this report (page ____). The scope of our examination reflects our assessment of control risk and includes tests of compliance with laws and regulations that we believe provide a reasonable basis for our opinion.”

(2) An example paragraph where internal control audits have not been performed at a nonmajor contractor might read:

“Our assessment of control risk reflects that we have not specifically tested the effectiveness of XYZ's systems and related internal controls.”

(3) An example paragraph where the contractor's accounting system has been audited and deemed inadequate or inadequate in part might read:

“For FY 20XX [*the fiscal year(s) under audit*], we considered XYZ's accounting system to be inadequate in part for the accumulation, reporting, and billing of costs on government contracts. As described in the Contractor Organization and Systems section of this report (page ____), XYZ's incurred cost submissions have been overstated in the

past because of a lack of policies and procedures to identify and exclude unallowable costs. The scope of our examination reflects the risk of unallowable costs being included in the submission and includes expanded testing to provide a reasonable basis for our opinion.”

b. If the concurrent MAARs were considered necessary to complete the audit but could not be accomplished for the period audited (6-105.4), insert the following additional statement in the scope paragraph:

“The concurrent verification of (*indicate whether labor, materials or both*) was omitted in this examination (*if accomplished in at least one year of a multi-year examination, state fiscal years omitted*).”

10-504.4 Qualifications

a. Identify any circumstances encountered that have a significant adverse effect on the audit or results. (See 10-210.4 for general guidance and 6-708.1 and 6-709.2 for specific limitations.)

b. If the incurred cost audit report is issued before receipt of the assist audits on subcontract or intercompany costs, as discussed in 6-709.2c., the following information should be included in a report note or schedule for each unresolved subcontract/intercompany order.

- subcontract/intercompany order number
- subcontractor/intercompany name
- subcontractor/intercompany billed/claimed amount for the year
- date assist audit requested
- name of the audit office performing the assist audit
- expected assist audit report date

c. The unaudited subcontract/ intercompany costs would be classified in the report as unresolved, pending receipt of the assist audits. The report should also say that upon receipt of the assist audit report, the recommended subcontract/inter-company costs included in the report will be reconciled with the related costs in the upper tier contractor's incurred cost submission, and supplemental reports will be issued as required.

10-504.5 Results of Audit

Begin this paragraph with the phrase, “In our opinion . . .” If the report is qualified, modify the opinion statement, “In our opinion, except for . . .” Detail the major findings of the indirect and direct cost audit in this paragraph. Examples of lead in sentences for this section may read:

a. Indirect Rates

Example 1 (Indirect rates accepted as proposed.)

“Indirect Rates. In our opinion, [*except for the (describe the qualification and the potential impact on the results)*] the contractor's indirect rates are acceptable as proposed.”

Example 2 (The auditor's indirect rate adjustments were accepted by the contractor.)

“Indirect Rates. In our opinion, [*except for the (describe the qualification and the potential impact on the results)*] the contractor's proposed indirect rates are acceptable as adjusted by our examination. The examination results and recommendations are presented below. The enclosed Indirect Cost Rate Agreement documents the contractor's concurrence with our findings and recommendations.”

Example 3 (The auditor's indirect rate adjustments were not accepted by the contractor.)

“Indirect Rates. In our opinion, the contractor's proposed indirect rates are not acceptable as proposed. The examination results and recommendations are presented below.

The contractor did not accept our findings and recommendations with respect to [*state major areas of disagreement*]. [*If audit-determined rates, include the following sentence:*] The amounts disapproved are set out in the attached DCAA Form(s) 1.”

b. Direct Costs

Example 1 (No direct costs questioned.)

“Direct Costs. In our opinion, *[except for the (describe the qualification and the potential impact on the results)]* claimed direct costs are acceptable and are provisionally approved pending final acceptance. Final acceptance of amounts proposed under government contracts does not take place until performance under the contract is completed and accepted by the cognizant authorities and the audit responsibilities have been completed.”

Example 2 (Direct costs questioned.)

“Direct Costs. In our opinion, *[except for the (describe the qualification and the potential impact on the results)]* the contractor’s claimed direct costs are acceptable as adjusted by our examination. We questioned \$ ___ of direct costs proposed under government contracts. *[Briefly describe the reasons for the major cost exceptions.]* Questioned direct costs by element within specific contracts are presented in Exhibit __, page __. Direct costs not questioned are provisionally approved pending final acceptance. Final acceptance of amounts proposed under government contracts does not take place until performance under the contract is completed and accepted by the cognizant authorities and the audit responsibilities have been completed.”

c. Indirect Costs Subject to Penalty

This paragraph applies to reports on incurred cost audits covering locations (1) having contracts active in the period under audit that contain FAR clause 52.242-3 or DFARS clause 252.231-7001, and (2) corporate offices allocating costs to such locations. Include this paragraph when contracts which contain, or should have contained the identified clauses were active in the period and indirect costs are questioned (see 6-609 and examples at Figures 10-5-1 and 10-5-2).

Example 1 (No questioned costs are subject to the penalty.)

“Penalties for Unallowable Costs. None of the indirect costs questioned in this examination appear to be subject to the penalties provided in (*cite FAR or DFARS as discussed in Figure 10-5-1*).”

Example 2 (Questioned costs are subject to the penalty.)

“Penalties for Unallowable Costs. Indirect costs questioned in this examination are believed to be subject to the penalties provided in (*cite FAR or DFARS as discussed in Figure 10-5-1*). Our recommendations for each questioned item are included in the notes to Exhibit(s) __ and their supporting schedules. Affected contracts are identified in Exhibit __, page __. Our recommendations concerning the interest to be recovered on unallowable costs paid will be furnished when we have received your determination on penalties to be assessed.”

See 6-609.1f.(7) for additional reporting requirements when questioned costs subject to the penalty are less than \$10,000.

d. Exhibits and Schedules. The Results of Audit section of the report should contain all exhibits and supporting schedules required for a clear, complete presentation of the audit results. The specific procedures for achieving this reporting standard follow.

(1) In preparing the audit report, include the following categories of costs in the exhibits for each cost pool:

- Proposed Indirect Costs (Pool, Base and Rate)
- Voluntary Deletions
- Total Questioned Costs
- Questioned Costs (Concurred)
- Questioned Costs (Nonconcurrent) (Attach DCAA Forms-1 if rates are audit determined)

(2) Summarize the results of audit in an exhibit format, showing the pool and base amounts for each indirect rate as proposed by the contractor and as questioned by the auditor. Include a table in this exhibit showing the extent of government participation in the contractor's indirect allocation bases.

(3) Detail the audit results for each indirect cost rate classification in separate exhibit.

its, with supporting schedules as required. Modify the presentation to accommodate complex rate determinations and negotiation problems. Questioned costs for each cost element or account should be supported by explanatory notes presented in the format discussed below. The auditor can briefly describe the reasons for the questioned costs in those instances when the contractor concurs. When advance agreements or special provisions governing specific contracts are in effect, reference the Other Matters to be Reported Appendix (10-505.1) in the explanatory notes associated with the applicable costs. Cross-reference the exhibits, schedules, appendixes, and the narrative portion of the report. Explanatory notes should be in the following format:

(a) Summary of Conclusions. Provide a summary statement on the audit findings and comments, which explain why these costs were not accepted. Provide the basis for the questioned costs including a description of the questioned costs, details on the calculation of questioned costs, and a specific reference to the regulatory support such as the cost principle, cost accounting standards, or contract terms.

(b) Basis of contractor's cost. Describe the basis of the contractor's submitted costs. Include enough detail to permit the contracting officer to fully understand how the contractor charged the specific cost element.

(c) Audit evaluation. Describe the steps taken to evaluate the cost element. When quantitative methods are used as a basis for the audit conclusions, these should be described. The report should adequately explain the computations and rationale supporting the conclusion; however, it need not include statistical measurements which are not relevant to negotiations. When statistical sampling methods are used, the projected value or amount and how that value or amount was calculated will be described. If the results of the statistical sampling methods were not projected across the universe (see 4-605), an explanation will be provided for why it was inappropriate to project the results. Also include references to any "Qualifications" and fully describe the effect these circumstances have on the submitted costs.

(d) Contractor's reaction. Provide a statement that the contractor either agreed or disagreed with the questioned costs and the basis for any disagreement.

(e) Provide the auditor's response, if the contractor disagrees with the questioned costs.

(4) If the contractor concurs in the questioned costs, use auditor judgment on the extent of explanation needed to describe the questioned costs.

(5) If direct costs are questioned, include an exhibit summarizing the results of the audit of direct costs. Questioned direct costs should be supported by explanatory notes, in the same format as discussed above. The auditor can briefly describe the reasons for the questioned costs in those instances when the contractor concurs. Questioned amounts should be identified by procuring office, by contract, and by cost element.

(6) If the contractor's submission applies to contracts which contain, or should contain the FAR or DFARS penalty clause and costs are questioned during the audit, include a schedule identifying questioned costs within pools by penalty class, amount, and percent of base subject to penalty (see Figure 10-5-1). For corporate home office expenses, the schedule should also include the allocable share for each division (see Figure 10-5-2).

(7) Include an exhibit listing all government cost-reimbursement and flexibly priced contracts and subcontracts performed during the fiscal period. Indicate those contracts and subcontracts with advance agreements or governed by special provisions. Contracts which contain, or should contain the FAR or DFARS "Penalties for Unallowable Costs" clause must be identified through a footnote (contracts from which the penalty clause has been inadvertently omitted should be separately identified). Request the contractor to furnish the complete exhibit or the necessary information subject to your selective verification. Group the contracts by military departments or other government agencies concerned. Identify prime contracts and subcontracts by number and reference subcontracts to the prime contractor and prime contract number.

(8) Include a schedule showing the cumulative allowable costs (inception to date) by contract or subcontract (see Figure 6-7-3). If not practical (e.g., if the schedule would be too voluminous), make reference to the specific records that detail the allowable costs by contract and subcontract. (Note that the Indirect Cost Rate Agreement letter also includes this schedule as an enclosure, when practical; see 6-708.2c. If the schedule of cumulative allowable costs is included with the Indirect Cost Rate Agreement letter, it is not necessary to include it again here.)

e. Additional Remarks

(1) Conclude the Results of Audit narrative by providing remarks on the following items as appropriate: (a) DCAA Forms 1, (b) Indirect Cost Rate Agreements, or (c) Certificates of Final Indirect Costs. When discussing Forms 1, include an affirmative statement that the ACO was advised of the areas of disagreement, which led to their issuance.

(2) If questioned costs are believed to be subject to FAR 42.709 or DFARS 231-70 penalties, request that the contracting officer's decision be furnished promptly.

(3) If the audit report covers audit-determined rates and the contractor agrees with the audit findings, enclose a copy of the completed indirect cost rate agreement required by FAR 42.705-2(b)(2) with the audit report. In addition, include a specific reference to the attached indirect cost rate agreement in the narrative body of the report.

(4) Exit Conference

(a) If there were no findings, provide a summary of the exit conference. State the date held and the name and title of the contractor's designated representative(s) with whom the audit results were discussed as required by 4-304.4 and 10-210.5e.(1).

(b) If there were findings, in addition to the requirements in (4)(a) above, summarize the contractor's overall reaction and any major differences. If the contractor submitted a written response, reference the appendix that contains the contractor's official reaction. The summary might read as follows:

"We discussed the results of our examination with [*identify the contractor representative(s) by name and title*] in an exit conference held on [*date*]. [*If there are findings*] In response to our findings, [*summarize the findings and the contractor's reaction, if any.*] [*If the contractor provided a written response, also add*] The complete text of the contractor's response appears as Appendix [X]. [*If there are findings and the contractor provided no response, the following is an example of a statement that may be included.*] [*Identify the contractor representative*] reserved comment pending discussions with the Administrative Contracting Officer."

(5) Other Additional Remarks. See 10-210.5e. for other elements required in this portion of the narrative.

10-504.6 Contractor Organization and Systems

a. Contractor Organization.

Include information on the contractor's organization as discussed in 10-210.7.

b. Accounting System.

(1) For the contractor fiscal year audit, provide a brief summary of the accounting system or reference to the contractor's approved disclosure statement. Limit the description to the methods used for accumulating and allocating indirect costs to government contracts and other work of the contractor. Typically, this would consist of a listing of the various indirect cost pools with brief explanations of their composition and of the related bases for allocation.

(2) Describe any significant change in indirect cost accounting and allocation methods made by the contractor since the prior audit, and your conclusions as to the propriety of the change.

(3) Briefly describe the status of DCAA's audit of the contractor's accounting system for the fiscal year under audit. Provide the system opinion and any accounting system deficiencies outstanding during the year under audit and

the status of any contractor corrective action.

c. Contractor's "Systems". For major contractors and larger nonmajor contractors who have internal controls over some of the systems listed in 5-102d., this section should provide the background information on each relevant internal control system impacting the incurred cost audit (e.g., Material, Labor, and Indirect and ODC systems). (See 10-210.7c. through 10-210.7g.)

10-504.7 DCAA Personnel and Report Authorization

Conclude the narrative portion of the report with the information prescribed in 10-211.

10-505 Appendixes (Incurred Cost Reports)

Use appendixes as applicable to provide information and comments as described in the following paragraphs.

10-505.1 Appendix - Other Matters to be Reported

Use an appendix with this title to present any additional information, which cannot be conveniently included in the exhibits and schedules, and to cover any other matters which warrant the attention of the contracting officer. Use this appendix to describe any advance agreements and special provisions governing specific contracts as required by FAR 42.705-1(b)(2), unless this information is identified in the exhibit required by 10.504.5d.(7).

10-505.2 Appendix - Billing Rates

A billing rates appendix may be used to recommend billing rates when the indirect rates are contracting officer determined, or to establish billing rates when the indirect rates are audit-determined (FAR 42.704). Identify the period to which the recommended rates apply. Comments supporting the recommended rates should mention whatever factors you considered, such as cost trends, changes

in production volume, and shifts in areas of activity. The recommended rates should provide that the contractor will not be reimbursed for unallowable costs (see 6-705.1).

10-505.3 Other Appendixes

The report should include the following appendixes as applicable: DCAA Forms 1; Indirect Cost Rate Agreement; Certificate of Final Indirect Costs; assist audit reports; and contractor written comments to the audit results.

10-506 Reporting on Reviews of Low-Risk Incurred Cost Submissions

10-506.1 Standard of Review

Government Auditing Standards have incorporated Statements on Standards for Attestation Engagements (SSAE) in guidance covering fieldwork and reporting on financial related audits (2-100). Attestation standards permit negative assurance when the evaluation meets the standards for a review. The objective of a review is to accumulate sufficient evidence to limit attestation risk to a moderate level. Review procedures are typically limited to inquiries and analytical procedures. A desk review of an incurred cost submission may be performed if it is classified as low-risk (see 6-104.1) based on auditable dollars and known audit risk. Procedures (see 6-104.5) include evaluating the submission for completeness, unusual items, and significant changes, and mathematical verification of their accuracy. These, combined with the absence of audit leads indicating a high probability of significant questioned cost, are sufficient to support negative assurance on a desk reviewed proposal. Low risk proposals selected for audit will continue to be reported on in accordance with 10-504.

10-506.2 Report Elements

a. Cover Sheet. Assure that the review is never referred to as an examination, whether in the caption, in the table of contents section headings, or in headers.

b. Report Narrative

Subject of Review. Identify the contractor's submission, the period reviewed, and the purpose of the review (see 10-210.1b(3)). End this section with the statement:

"The proposal is the responsibility of the contractor. Our responsibility is to report our conclusions on the proposal based on our review."

Executive Summary. Because significant findings would require expansion of the evaluation from a review to an examination, this section should never be required. However, its use is not prohibited under exceptional circumstances.

Scope of Review. The scope statement should state the procedures applied, the standards to which claimed costs were compared, and that an examination was not performed. The paragraph may read,

"We determined that no significant costs were questioned in prior years and that no indicators of audit risk had been identified. Accordingly, we limited our review to the verification of the mathematical accuracy of the proposal, a limited review of claimed costs for unusual items and items having obvious potential for including significant unallowable costs, and for compliance with special contract terms and conditions. We conducted our review in accordance with generally accepted government auditing standards. A review is substantially less in scope than an examination, the objective of which is the expression of an opinion on ABC's incurred cost proposal. Accordingly, we do not express an opinion."

Qualifications (if applicable). Limitations on scope arising from the decision to perform a review rather than an examination will not be described as qualifications. Since search and verification procedures such as subcontract assist audits and MAARs are omitted from the scope of a review, this section is unlikely to be needed.

Results of Review. Begin this section with the statement,

"Based on our review, nothing came to our attention that caused us to believe that significant costs claimed on the government contracts identified in [*Exhibit of Contracts*] were unallowable, unallocable or unreasonable [*except as stated below*]."

Incorporate other Results sections as appropriate:

- Exhibits and Schedules [if necessary]
- Exhibit of Contracts (with annotations to those contracts that include the penalty clause, if any.)
- Schedule Listing Cumulative Allowable Costs by Contract
 - c. Contractor Organization and Systems (when available)
 - d. DCAA Personnel and Report Authorization (see 10-211).
 - e. Report Distribution and Restrictions (see 10-507)
 - f. Appendixes [if necessary] (see 10-505)

10-507 Distribution (Incurred Cost Reports)

a. Distribute one copy of the report to the following:

(1) Other DoD contracting officers or procurement officers administering a significant portion of the contractor's total government business.

(2) The contract audit coordinator, if any.

(3) The prime contract auditor, if applicable. To facilitate distribution within the receiving FAO, the distribution list should identify the prime contractor(s) whose subcontracts are included in the period covered by the report. List the prime contractor name with the address of the FAO believed to be cognizant of the prime contractor:

DCAA-National Branch Office
20251 Century Boulevard
Germantown MD 20874-1162

Prime: Loral Federal Systems

(4) When applicable, the onsite FLA (refer to 15-3S1) who provides service to the contracting officer responsible for the negotiation of the final indirect cost rate.

(5) Upon specific request, other organizations consistent with 10-205 and the report restrictions (See 10-212 and Figure 10-2-4).

(6) The contractor, through the contracting officer, unless the report is restricted in accordance with 10-212.2.

b. Non-DoD Organizations: When specifically requested or, except for the cognizant NASA IG, if the procurement office has a significant portion of the contractor's total government business, distribute a copy of the incurred cost audit report to non-DoD organizations as shown below:

(1) National Aeronautics and Space Administration (NASA).

(a) NASA Contractors (see 10-212 and 15-100):

(b) NASA Office of Inspector General, Assistant IG for Auditing (see Supplement 15-1S1). A copy of the audit report should be sent only if specifically requested by NASA.

(c) NASA Procurement Contracting Officer(s) at NASA Procurement Center(s) (see Supplement 15-1S2) doing business with the contractor.

(d) Local NASA contract administration office (if any).

(2) Department of Transportation (see Supplement 15-1S4).

(3) Department of Agriculture (see Supplement 15-1S5).

(4) Department of Health and Human Services, Regional Audit Director (see Supplement 15-1S3).

(5) Department of Housing and Urban Development, Director:

Headquarters Audit Operations

Office of Audit

Office of Inspector General

DHUD 451 7th Street, SW

Washington, DC 20410

(6) Environmental Protection Agency Audit Division Director (see 15-116).

Figure 10-5-1
Schedule Of Unallowable Costs Subject To Penalty

Audit Report No. _____

Schedule _____

SCHEDULE OF UNALLOWABLE COSTS SUBJECT TO PENALTY

Period _____ Through _____

	<u>Amount Subject to FAR 42.709 (DFARS 231.7002)*</u>			
	<u>Questioned Costs</u>	<u>Level One Penalty</u>	<u>Level Two Penalty</u>	<u>Reference</u>
<u>Cost Element</u>				
Engineering Overhead:				
Consultants	\$150,000	\$100,000	\$	SEE NOTE
Depreciation	100,000	100,000		BELOW***
Pension	100,000	100,000		
Relocation	100,000	50,000		
Legal Fees	80,000	40,000		
Professional Actv.	80,000	80,000		
Travel	75,000	20,000		
Insurance	25,000	25,000		
Entertainment	25,000		25,000	
Totals	<u>\$735,000</u>	<u>\$515,000</u>	<u>\$25,000</u>	
<u>Participation of Contracts Subject to Penalty Clause</u>				
		<u>Total</u>	<u>With Clause</u>	<u>No Clause</u>
Allocation Base		\$40,000,000	\$8,000,000	\$32,000,000
Percent of Base		100%	20.0%	80.0%
Questioned Costs Subject to Level One Penalty (\$515,000 X 20%)			\$103,000	
Questioned Costs Subject to Level Two Penalty (\$25,000 X 20%)			\$ 5,000	

*Reference DFARS 231.7002 also if there are open DoD contracts in excess of \$100,000 awarded between February 26, 1987 and October 1, 1995 (see 6-609).

***NOTE: INCLUDE REFERENCES TO NOTES IN THE EXHIBIT CONTAINING THE PENALTY INFORMATION AS DISCUSSED IN CAM 10-504.5d(6).

Figure 10-5-2
Home Office Expense
Schedule Of Unallowable Costs Subject To Penalty

Audit Report No. _____

Schedule _____

HOME OFFICE EXPENSE
SCHEDULE OF UNALLOWABLE COSTS SUBJECT TO PENALTY

Period _____ Through _____

	<u>Amount Subject to FAR 42.709 (DFARS 231.7002)*</u>			
	<u>Questioned Costs</u>	<u>Level One Penalty</u>	<u>Level Two Penalty</u>	<u>Reference</u>
Consultants	\$500,000	\$300,000		See Note
Lobbying	150,000	150,000		Below***
Advertising	100,000	100,000		
Public Relations	100,000	100,000		
Relocation	80,000	40,000		
Travel	<u>50,000</u>	<u>20,000</u>		
Totals	<u>\$980,000</u>	<u>\$710,000</u>		
<u>Allocation to Divisions</u>				
<u>Division</u>	<u>% Allocable</u>	<u>Amount</u>		
Missile	60.0%	\$426,000		
Submarine	20.0%	142,000		
Service Co.	10.0%	71,000		
Research	<u>10.0%</u>	<u>71,000</u>		
Total	<u>100.0%</u>	<u>\$710,000</u>		

*Reference DFARS 231.7002 also if there are open DoD contracts in excess of \$100,000 awarded between February 26, 1987 and October 1, 1995 (see 6-609).

***NOTE: INCLUDE REFERENCES TO NOTES IN THE EXHIBIT CONTAINING THE PENALTY INFORMATION AS DISCUSSED IN CAM 10-504.5d(6).

10-600 Section 6 --- Audit Reports on Postaward Audits of Cost or Pricing Data

10-601 Introduction (Postaward Reports)

a. This section provides guidance for preparing and distributing reports on postaward audits of contractor cost or pricing data for compliance with 10 U.S.C. 2306a. Such reports embody the results of audits performed using the guidance in 14-100. Auditors sometimes refer to these audits as “defective pricing audits,” “audits for possible defective pricing,” etc. In audit reports, however, FAOs should use the terms employed in this section.

b. Throughout this section the term “contracting officer” includes their representatives. The term “contract” also applies to subcontracts except where this section specifically notes a distinction.

c. Government Auditing Standards incorporate Statements on Standards for Attestation Engagements (SSAE) in guidance covering fieldwork and reporting on financial related audits. Attestation standards prohibit evaluation of an entity's compliance with laws or regulations under the standards for a review. The objective of a postaward audit is expression of an opinion on the entity's compliance with the requirements of the Truth in Negotiations Act (10 U.S.C. 2306a) in negotiating the contract under audit. Accordingly a defective pricing evaluation must be performed and reported under the standards for an examination, with the objective of expressing an opinion on the assertion (cost or pricing data) underlying the pricing action (prime contract, modification, subcontract, etc.).

10-602 Nature and Timing of Reports (Postaward Reports)

a. The cost or pricing data for each pricing action (prime contract, modification, subcontract, etc.) is subject to a separate defective pricing audit. Therefore, separately report apparent defective pricing found on each pricing action. When reporting systemic defective pricing issues, however, see 14-120 and 10-606.6. Issue all audit reports promptly,

whether or not apparent defective pricing is disclosed. However, see 10-605.1c.(1) for the issuance of a prime postaward audit report when a subcontract postaward audit is not complete.

b. For subcontract reporting, it is usually easier for the prime contract auditor to apply the prime contractor's additives to recommended subcontract price adjustments. The prime contract auditor may also need to perform other audit actions at the prime contract level, such as those involving possible “offsets” or the issuance of appropriate disapprovals under flexibly priced contracts for recommended subcontract price adjustments. Therefore, issue subcontract audit reports to the prime contract auditor. (However, see 4-702.8 for comments on issuing subcontract audit reports when there is alleged subcontractor fraud in connection with the defective pricing audit.) This procedure usually results in earlier holding of an exit conference with the prime contractor. It also provides for earlier involvement by the prime contract auditor in eventual negotiation of recommended prime contract price adjustments.

10-603 Report Format and Contents (Postaward Reports)

a. The nature and extent of the detailed report depends on (1) whether or not the audit disclosed apparent defective pricing, (2) materiality of recommended price adjustments, (3) results of discussions with the contractor including those involving offsets, and (4) items of special interest to the contracting officer or other authorized requestor.

b. Provide the information as stated in 10-606 regardless of audit findings.

c. Prepare the report using the basic guidance contained in 10-200 plus the supplemental information provided by this section. A “shell” report is provided on the APPS and the DCAA Intranet.

d. The general arrangement of report contents follows.

Cover sheet (see 10-205)

Narrative body of report (see 10-606)

Subject of Audit (10-606.1)

Executive Summary (10-606.2)
 Scope of Audit (10-606.3)
 Qualifications (10-606.4)
 Results of Audit (10-606.5)
 Opinion
 Exhibits and schedules
 Unsatisfactory Conditions (10-606.6)
 Additional Remarks (10-606.7)
 Contractor Organization and Systems (10-606.8)
 DCAA Personnel and Report Authorization (see 10-211)
 Report Distribution and Restrictions (see 10-212)
 Appendixes (see 10-607)

(1) If the subcontractor does not object to the release of the report, add the sentence shown at 10-212.3c.(2).

(2) If the subcontractor objects to the release of company proprietary information, which may be included in the audit report, the following statement will be included:

“[Name of subcontractor] considers [identify the data which the subcontractor objects to releasing] to be trade secrets or confidential business information. Accordingly, the contracting officer should protect such information from improper disclosure in accordance with FAR 15.407-1(f).”

10-604 Cover Sheet (Postaward Reports)

10-604.1 General Information

Follow the general format in 10-205 and Figure 10-2-1. Include the title of the report (Report on Postaward Audit of Cost or Pricing Data) on the subject line, the prime contract number and the subcontract identification, if applicable, on the reference line, and the contractor's name, city, and state on the contractor line.

10-604.2 Release of Subcontract Audit Report to the Higher-Tier Contractor

a. If a government audit discloses defective subcontractor cost or pricing data, FAR 15.407-1(f) provides for contracting officer release of information, upon request to prime contractors or appropriate subcontractors to the extent necessary to secure a prime contract price reduction. However, the contracting officer must be careful to protect confidential business information from improper disclosure in such situations.

b. A reference line for release restrictions will be included on the cover sheet of subcontract defective pricing audit reports and on higher-tier contractor audit reports containing recommended subcontractor price adjustments. The release statement will appear in the report section entitled “Audit Report Distribution and Restrictions.”

10-605 Addressing and Distributing Reports (Postaward Reports)

The general policy for addressing audit reports is stated in 10-206. Paragraph 10-212 states the general policy for report distribution. For reports covered by this section, include the onsite FLA (refer to 15-3S1) on the distribution list.

10-605.1 Addressing and Distributing Prime Contract Audit Reports

a. If the auditor performed the postaward audit of cost or pricing data in response to a specific government request, address the report to the requestor with a copy to the plant representative/ACO and/or the PCO, as appropriate.

b. If DCAA initiated the audit, address the report to the PCO with an information copy to the plant representative/ACO, unless the plant representative/ACO has negotiation authority. In that event, address the report to the plant representative/ACO with a copy to the PCO. With the case of Wright Patterson Air Force Base (WPAFB), a centralized group has responsibility for positioning postaward audit findings in lieu of the PCO. The audit report should still be addressed to the PCO, with a copy furnished to the plant representative/ACO; however, an additional copy should be furnished to ASC Pricing, PKFB. The contract will identify negotiation authority for orders

tion authority for orders issued under basic ordering agreements.

c. The prime contract auditor will incorporate positive subcontract audit report findings and make distribution of a combined report (see 10-605.2).

(1) When the prime auditor becomes aware that a prime audit and a subcontract audit are scheduled to be performed in the same period, the prime auditor should incorporate results of the subcontract audit where incorporation of the subcontract audit will not cause an undue delay in the issuance of the prime contract audit report. If the incorporation of the subcontract audit will cause an undue delay in the issuance of the prime contract audit report, the prime auditor should issue the prime report without incorporating the results of the subcontract audit.

(2) When the prime contract auditor is unable to complete the prime contract audit and issue a combined report within 30 days of receiving a subcontract audit report with positive findings, he or she will, as an interim measure, issue and distribute an audit report that includes the subcontract findings and the prime contractor's add-ons. See 14-119.4 for the proper application of prime contractor add-ons.

d. If the prime contract is flexibly priced and the subcontract audit report recommends disallowance or nonrecognition of incurred costs (see 14-119.4b.), the prime auditor will immediately advise the PCO. Timely action (1) allows the PCO to notify the prime contractor that the increased costs may be disallowed or not recognized on the prime contract and (2) enables the prime contractor to exercise the price reduction clauses it should have in its contract with the subcontractor. Delays in reporting subcontractor defective pricing may prevent the prime contractor from obtaining a subcontract price reduction, thus precluding the prime's legitimate recovery of its costs.

e. Distribute one copy of each report with apparent defective pricing on Army contracts, certain Air Force contracts, and contracts issued by any contracting activity of the Defense Logistics Agency as shown in supplement 10-6S1.

f. One copy of any report regarding apparent defective pricing on NASA prime

contracts may be sent to the NASA OIG for Auditing (15-1S1) if specifically requested.

10-605.2 Addressing and Distributing Subcontract and Intracompany Audit Reports

a. For a subcontract or intracompany audit that was performed in response to a request by a contracting officer or other authorized person or activity, address the report to the requestor with a copy to the prime contract auditor.

b. For a subcontract or intracompany audit report on a DCAA initiated audit, address the report to the prime contract auditor. Follow the release requirements in 10-212.3. Do not distribute copies of these reports outside DCAA, since the prime contract auditor will make distribution of the combined report, if appropriate. The prime contract auditor will distribute the combined report as provided in 10-605.1.

c. Follow procedures similar to the above when dealing with lower-tier subcontracts. The prime contract auditor is responsible for obtaining intermediate-tier subcontractor add-ons when there are positive findings below the first tier of subcontracts.

10-606 Narrative (Postaward Reports)

The body of the report will contain the following captioned paragraphs as applicable. See 10-200 for general guidance.

10-606.1 Subject of Audit

The first portion of this section should identify the pricing action audited and the purpose of the audit. It should also include information about the contract such as contract type, incentive provisions, total value of the pricing action covered by the audit, items purchased, and other appropriate information. Opening statements for five common situations could read as follows:

Example 1 (Prime contract audit requested by contracting officer):

"As requested by [requesting office] in [memorandum/letter] [reference] dated ____, we examined contractor cost or pricing data related to initial

pricing of the subject contract. The purpose of the examination was to test whether the price, including profit, negotiated in that pricing action was increased by a significant amount because the contractor furnished cost or pricing data that was not accurate, complete, and current as required by 10 U.S.C. 2306a. In its Certificate of Current Cost or Pricing Data dated __, the contractor certified the data as of __, the date of agreement on price. The contract, initially priced at \$ __, is firm-fixed-price type and provides for production and delivery of __. A Chronology of Significant Events concerning our examination of the cost or pricing data related to the pricing action is included as an appendix to this report.

The cost or pricing data are the responsibility of the contractor. Our responsibility is to express an opinion on whether the cost or pricing data submitted during the negotiation of [*pricing action*] complied with the requirements of 10 U.S.C. 2306a.”

Example 2 (DCAA initiated audit):

“As part of our continuing program of evaluating contractor compliance with 10 U.S.C. 2306a and implementing regulations, we examined [*contractor cost or pricing data related to the pricing of Supplemental Agreement No. 4 to the subject contract.*] The purpose of the examination was to test whether the price, including profit, negotiated in that pricing action was increased by a significant amount because the contractor furnished cost or pricing data that was not accurate, complete, and current as required by the cited statute.

In its Certificate of Current Cost or Pricing Data dated __, the contractor certified the data as of __, the date of agreement on price. The fixed-price-incentive contract provides for development, test, and evaluation of __. The net target price added to the contract by the pricing action was \$ __. A Chronology of Significant Events concerning

our examination of the cost or pricing data related to the pricing action is included as an appendix to this report.

The cost or pricing data are the responsibility of the contractor. Our responsibility is to express an opinion on whether the cost or pricing data submitted during the negotiation of [*pricing action*] complied with the requirements of 10 U.S.C. 2306a.”

Example 3 (Subcontract or intra-company audit requested by contracting officer or is DCAA initiated):

Modify Examples 1 and 2 by substituting “subcontract” or “intracompany order” for “contract” wherever applicable.

Example 4 (Cost-reimbursement type contract):

For cost-reimbursement type contracts, the statement on purpose of the audit should not refer to “the price, including profit.” Instead, use the following wording:

“The purpose of the examination was to test whether the estimated cost or fee negotiated in that pricing action, or any cost reimbursable under this contract, was increased . . .”

Example 5 (Lack of Certificate of Current Cost or Pricing Data):

If the contractor did not execute a Certificate of Current Cost or Pricing Data in connection with the pricing action(s) being reported on, modify the appropriate sentence in Examples 1 and 2. It may state, for example:

“In the absence of the contractor's Certificate of Current Cost or Pricing Data for this pricing action, we have treated __ [*the date that price agreement was reached or the date the contract (or modification) was executed*] as the effective date of the contractor's responsibility for the cost or pricing data submitted. A Chronology of Significant Events concerning our examination of the cost or pricing data related to the pricing action is included as an appendix to this report”

10-606.2 Executive Summary

Provide a brief overview of the audit findings (qualified, if appropriate) in the Executive Summary section of the report. The summary by defective pricing issue is helpful to contracting officers because contractors often respond by issue. This type of information should be provided here if requested by the contracting officer. An example of suggested wording follows:

“Our examination disclosed that Air Systems overstated tooling repair and maintenance (TR&M) material costs as a result of submitting inaccurate cost or pricing data. The audit baseline and recommended adjustment are summarized as follows:

Audit baseline	\$67,045,794
Recommended	
Price Adjustment\$	326,088

SIGNIFICANT ISSUES:

- Air Systems made an error when computing proposed TR&M material costs. As a result, the proposal was overstated by \$225,237.
- The remaining recommended price adjustment results from applying the material burden, G&A expense, cost of money and profit rates to the overstated amount proposed for the TR&M material costs.
- Air Systems agrees with the total recommended price adjustment.”

10-606.3 Scope of Audit

a. Include an appropriate scope of audit statement, modified for circumstances that significantly affected the audit scope. Tailor the scope statement to accurately reflect the extent of audit work performed. Describe the impact of the current assessment of control risk for the estimating system on the postaward audit. In addition, use this section to describe any advance agreements and special contract provisions, which influenced the auditor's decision to recommend or not recommend a price adjustment. Use the following scope statements, as appropriate:

Example 1 (Unqualified report):

“We conducted our examination in accordance with generally accepted government auditing standards. Those standards require that we plan and perform the examination to obtain reasonable assurance about whether the data and records evaluated are free of material misstatement. An examination includes:

- evaluating the contractor's internal controls, assessing control risk, and determining the extent of audit testing needed based on the control risk assessment;
- examining, on a test basis, evidence supporting the amounts and disclosures in the data and records evaluated;
- assessing the accounting principles used and significant estimates made by the contractor;
- evaluating the overall data and records presentation; and
- determining the need for technical specialist assistance [*and quantifying the results of a government technical evaluation*].

The criteria used to evaluate the cost or pricing data included the public law contained in FAR Subpart 15.4 and [*the advance agreements and other pertinent provisions of the contract as referenced in Appendix _*]. The contractor's estimating system is considered adequate to ensure that forward pricing proposals and the final certified contract price are based on accurate, complete and current cost or pricing data. Our audit scope reflects our assessment of control risk and provides a reasonable basis for our opinion.”

NOTE: For an inadequate estimating system, see 10-606.3b. for sample language.

Example 2 (Qualified report):

Precede the words “We conducted our examination” in the first sentence of Example 1 by the phrase “Except for the qualifications discussed below,”

Example 3 (Explanatory modification used when the auditor limited audit scope to that requested by the contracting officer and the audit conclusions are not qualified):

“To satisfy your specific request, we limited this current examination to the following aspects: [*insert specific information*]. Except for this limitation, we conducted our examination in accordance with generally accepted government auditing standards. Those standards require that we plan and perform the examination to obtain reasonable assurance about whether the data and records evaluated are free of material misstatement. An examination includes:

- evaluating the contractor's internal controls, assessing control risk, and determining the extent of audit testing needed based on the control risk assessment;
- examining, on a test basis, evidence supporting the amounts and disclosures in the data and records evaluated;
- assessing the accounting principles used and significant estimates made by the contractor;
- evaluating the overall data and records presentation; and
- determining the need for technical specialist assistance [*and quantifying the results of a government technical evaluation*].

The criteria used to evaluate the cost or pricing data included the public law contained in FAR Subpart 15.4 and [*the advance agreements and other pertinent provisions of the contract as referenced in Appendix _*]. The contractor's estimating system is considered adequate to ensure that forward pricing proposals and the final certified contract price are based on accurate, complete and current cost or pricing data. Our audit scope reflects our assessment of control risk and provides a reasonable basis for our opinion.

This report is limited to the pricing action under [*contract no.*] identified above. We may continue to audit other aspects of eligible pricing actions negotiated under the subject contract and may issue separate reports on them.”

NOTE: For an inadequate estimating system, see sample language below.

b. Estimating system assessment. Provide information on the adequacy of the estimating system internal controls and their impact on the scope of the postaward audit. The following is an example to be used when the estimating system is considered inadequate in part:

“The criteria used to evaluate the cost or pricing data included the public law contained in FAR Subpart 15.4. The contractor's estimating system is considered inadequate in part to ensure forward pricing proposals and final certified contract prices are based on accurate, complete and current cost or pricing data. Because of an outstanding estimating internal control deficiency, described in the Contractor Organization and Systems section of this report (page _), proposed material costs are often overstated. Our audit scope reflects our assessment of control risk and includes expanded testing to provide a reasonable basis for our opinion.”

10-606.4 Qualifications

a. Include a paragraph on circumstances affecting the audit only if the audit results must be qualified because the stated purpose and scope could not be accomplished. In such a case, both the “scope” statement and the “results of audit” paragraph must specifically refer to this paragraph. Do not refer to any unqualified audit conclusions and recommendations in this section. Properly explain them in the other portions of the report.

b. Clearly explain the nature and potential impact of each circumstance that prevents an unqualified conclusion, as well as any steps taken to overcome or mitigate the problem. If applicable, also explain any further action the auditor will take after issuing the report.

c. For situations involving more than one qualification, use sub captions to highlight the specific circumstances requiring a report qualification. For example, the sub captions might read “a. Con-

tractor's Denial of Access to Records” and “b. Inadequate Contractor Cost Records.”

10-606.5 Results of Audit

a. The auditor's opinion and details in support of the audit findings are provided in the Results of Audit section. Present all data and explanations using an exhibit type format to summarize the audit baseline and the results of the audit (see 14-116). Minimum data required are:

Audit baseline (see 14-116.2).

Recommended price adjustment (Enter the total recommended price adjustment or “none” if the amount is zero).

Adequately explain each price adjustment in the notes to the exhibits and schedules. Include the reason the item is defective by establishing that each of the five elements required for defective pricing have been met (see 14-102b.). In addition, include the relevant date for each recommended price adjustment when appropriate.

b. If the audit does not result in a recommended price adjustment, or the recommended price adjustment does not meet the guidelines in 14-120.1 for materiality, use wording similar to Example 1. If the results of audit reflect a recommended price adjustment, the basis of that adjustment should be fully explained in the explanatory notes (Example 2). On flexibly priced prime contracts, separately present findings in the prime audit report for (1) recommended price adjustments and (2) recommended disallowance or nonrecognition of incurred costs (14-119.4b.). Subcontract audit reports should clearly identify that the defective pricing at the subcontract level will result in disallowance or nonrecognition of incurred costs at the prime level. If the audit is qualified, make reference to the qualification paragraph.

Example 1 (Unqualified opinion with no audit exceptions):

“In our opinion, the contractor's certified cost and pricing data complied, in all material respects, with the requirements of 10 U.S.C. 2306a.”

Audit baseline	\$ _____
Recommended price adjustment	None

Example 2 (Unqualified opinion with audit exceptions):

“In our opinion, the cost or pricing data submitted by the contractor was not compliant in all material respects with the requirements of 10 U.S.C. 2306a because the data was not accurate, complete, and current as of the date of agreement on price. *[Briefly discuss the major recommended price adjustments, including a reference to any CAS reports issued per 14-120.2.]*

The results of our examination follow:”

Example 3 (Qualified opinion with possible added exceptions):

Insert any needed qualifying wording at the beginning of the first sentence in Example 1 or the second sentence in Example 2. Refer specifically to the possible effects, not merely to the circumstances that led to the qualification. If access was denied to historical cost records, Example 2 might include the following qualification:

“Except for additional recommended price adjustments, if any, that might result from access to the historical cost records of previously manufactured items as discussed above, the results of our examination follow:”

c. Paragraphs 10-606.5a. and 14-123 list minimum data required for exhibits and schedules. As discussed in 14-123, each audit report with a recommended price adjustment must specifically list the five points for establishing defective pricing in the explanatory notes and discuss how each point has been met (14-102b.). Highlights to be addressed in discussing the five points include:

- In discussing the first point, provide the relevant parts of the FAR definition of cost or pricing data along with an explanation of how the data in question fits the FAR definition. See 14-104.3.
- In discussing the second point, provide the date that the defective data was reasonably available to the contractor and the date of price agreement or, if applicable, the other date agreed upon

between the parties. Emphasize that the availability date was prior to the date of price agreement. See 14-104.6.

- In discussing the third point, address how the auditor was able to confirm that the contractor did not submit the data (e.g., no record of submission in contractor or government proposal files) and that the government had no actual knowledge of the data (e.g., PNM language and confirming memorandum). See 14-105.
- In addressing the fourth point, discuss how reliance was confirmed, such as the date for the PNM and the confirmation memorandum from the contracting officer. See 14-116.1 and 14-122.
- In addressing the fifth point, explain how the government's reliance on the defective data caused an increase in price.

d. Clearly identify details on significant offsets alleged by the contractor. Do this in a fashion similar to that used for explanatory notes. If appropriate, auditors can merely make reference to them here and cover the details in a separate exhibit. If the contractor has not submitted appropriate offset certifications for contracts entered into on or after February 15, 1987 (14-118b.), include in the report an additional statement that the contractor refused to provide a certification and, for this reason, we have not included the claimed offsets in our computation of the recommended price adjustment and do not express an opinion on the claimed offsets. Make reference to the auditor's notification for contracting officer assistance to obtain contractor certification prior to issuing the report.

e. When postaward audits disclose overpayments resulting from defective pricing on (1) DoD contracts or modifications awarded after November 7, 1985 or (2) other government contracts or modifications awarded after January 22, 1991, include the following statement as part of this portion for prime contract audit reports (see 14-124):

"The government sustained a loss in the form of interest on overpayment which resulted from the contractor's failure to comply with the Truth in

Negotiations Act (10 U.S.C. 2306a). As provided by the statute (*applicable to DoD contracts*) and/or FAR 15.407-1(b)(7) (*applicable to contracts of all government agencies*), this interest amount is computed at the current rate prescribed by the Secretary of the Treasury under Section 6621 of the 1986 Internal Revenue Code, from the time of the overpayment to the date the government is repaid."

f. When postaward audits at subcontractors disclose overpayments resulting from defective pricing on subcontracts meeting the conditions in e. above, the subcontract auditor should include in this portion of the report the statement in e. above and add the following sentence at the end of the paragraph:

"Recommendations on interest due as a result of government overpayments will be made by the prime contract auditor."

g. Provide exhibit information regarding interest only if requested by the contracting officer. If exhibit information is provided, add the following sentence to the above statement:

"See page __, Exhibit __ for details the responsible procuring official will need for making the computation."

See 14-124 and Figure 14-1-1 for an explanation of the information to be included in the exhibit.

10-606.6 Systemic and/or Unsatisfactory Conditions

a. To promote consistency in resolving cases where the cited condition is systemic, report the systemic findings in a single report that identifies all affected pricing actions and contracting officers and identify the systemic nature of the condition. See 14-120.3b. for guidance on coordination with contracting officers. If other reports were already issued before the systemic nature of the issue was known, include the following statement:

“In our opinion the condition resulting from submission of the inaccurate, incomplete, or noncurrent data identified on page __, Note __, is systemic. We have issued similar audit reports on other affected contracts. To assist in the timely and consistent resolution of the reported findings, a current list of these reports and the affected PCOs is included in Appendix __.”

b. When there is reasonable basis to suspect that the contractor knowingly submitted inaccurate, incomplete, or noncurrent cost or pricing data, issue a referral of suspected irregular conduct using DCAA Form 2000.0. Following the procedures in 4-702.5, transmit a copy of the form to the contracting officer only if the responsible investigative agency does not object (see DCAAI 7640.16). For DoD contracts or modifications awarded after November 7, 1985, include the following statement in the transmittal:

“Notwithstanding any potential civil or criminal fraud violations, 10 U.S.C. 2306a, as amended by Section 952(a) of the 1987 Defense Authorization Act, states that a contractor who knowingly submits inaccurate, incomplete, or noncurrent cost or pricing data must pay a penalty in an amount equal to the overpayment. In our opinion, there is a reasonable basis to conclude that [contractor name] made a knowing submission as contemplated under the statute and, therefore, is liable to the government for \$ [amount].”

c. When a pattern of deficiencies or discrepancies suggests fraud, other unlawful activity, or the existence of unsatisfactory conditions, refer or report the matter using the guidance in 4-700 or 4-800.

10-606.7 Additional Remarks

a. Use this paragraph to confirm that factual matters relating to any apparent defective cost or pricing data were coordinated with the procuring contracting officer

(PCO) or the PCO's representative during the course of the audit. (Provide auditor's name and title and PCO's name and title.) In addition, include a statement that a copy of the draft report exhibits and explanatory notes describing the recommended price adjustments were provided to the PCO (provide PCO name and date) in order to ensure that a mutual understanding of the facts and issues was reached (CAM 14-122). Also see 10-210.5e for other elements required in this portion of the narrative.

b. Exit Conference

(1) If there were no findings, state the date held and name and title of the contractor's designated representative(s) with whom the audit results were discussed as required by 4-304.3 and 10-210.5e.(1).

(2) If there were findings, prepare the exit conference statement as follows:

(a) In addition to the requirements in 10-606.7b.(1) above, summarize the major recommended price adjustments.

(b) Include a summary of the contractor's reaction to the major recommended price adjustments and the date that the draft and notes explaining the findings were provided to the contractor. Note, however, that comments on offsets alleged by the contractor are part of an earlier portion of the report (see 10-606.5d.). When appropriate, state that the report includes the contractor's complete written response as an appendix.

(c) In a brief auditor rejoinder following the summary of the contractor's reaction, discuss the validity of the contractor's response.

(d) An example of a report paragraph with recommended price adjustments and contractor reaction is as follows:

“We discussed the results of our examination with [identify the contractor representatives(s) by name and title] in an exit conference held on [date]. [Include a summary of the results.] In response to our findings, [include a summary of the contractor's reaction to the results.] The complete text of the contractor's response appears as Appendix [X]. [Include the auditor's rejoinder to

the results; discuss the validity of the contractor's response.]"

c. For apparent defective pricing cases with positive findings, request that the auditor be provided the opportunity to evaluate and comment on any data received after report issuance that pertains to report recommendations. Also request that the contracting office advise the audit office of the disposition of the audit recommendations (FAR 15.407-1(d)).

10-606.8 Contractor Organization and Systems

Include information describing the contractor's estimating system internal controls that affect the scope and results of audit. Also provide a listing of all internal control deficiencies that were relevant to the contract under audit during its proposal and negotiation stages. Provide the status of the contractor's corrective action for these deficiencies.

10-607 Appendixes (Postaward Reports)

Use an appendix only for required supplementary or supporting information, as explained in 10-213. The report body or an exhibit or schedule will refer to any appendix included as part of the report.

10-607.1 Chronology of Significant Events

Use this appendix to show the significant events concerning the postaward audit of cost or pricing data, including important dates for significant items reported in the exhibit to provide a clearer presentation.

10-607.2 Contractor's Written Remarks

If received, include as an appendix a copy of the contractor's written comments resulting from the exit conference (see 10-606.5).

10-6S1 Supplement --- Distribution (Postaward Reports)

Army

In those cases where the U.S. Army Aviation and Missile Command (AMCOM) is not the requesting office, distribute one additional copy of each report on apparent defective pricing on AMCOM prime contracts to:

Commander, U.S. Army Aviation and Missile Command
ATTN: AMSMI-AC-BM-B
Redstone Arsenal, AL 35898

Also, e-mail a copy of each report on apparent defective pricing on all contracts issued by U.S. Army Tank-Automotive & Armaments Command procurement offices (identified by Army Activity Address Numbers DAAE07, DAAE20, DAAE24, DAAE30, DAAE32) to audits@tacom.army.mil.

Air Force Materiel Command (AFMC)

Distribute one additional copy of each report on apparent defective pricing on prime contracts issued by AFMC procurement offices, identified by AF or F station codes as listed below, to the related pricing function as follows:

Codes Procurement Office

33600 Aeronautical Systems Center
33615 ATTN: ASC/PKFB
33657 Building 16
2275 D Street, RM 119
Wright-Patterson AFB, OH
45433-7237
E-mail: asc.pkf@wpafb.af.mil
19628 Air Force Electronics Systems Center
ATTN: PKF
104 Barksdale Street
Hanscom AFB, MA
01731-1806
04701 Space and Missile Systems Center
04693 155 Discoverer Blvd.
Suite 1213
Los Angeles AFB, CA
90245-4692

08635 Munitions Systems Center
ATTN: Pricing Office, PMF
Eglin AFB, FL 32542-5000
34601 Oklahoma City Air Logistics Center
34608 Center
34650 ATTN: Pricing Division
OC-ALC/PKF
3001 Staff Dr., Suite 2A184A
Tinker AFB, OK 73145-3015
42600 Ogden Air Logistics Center
42610 ATTN: Pricing Division
42620 OO-ALC/PKF
42630 6072 Fir Ave.
Bldg. 1233
42650 Hill AFB, UT 84056-5820
E-mail: chris.larsen@hill.af.mil
41608 San Antonio Air Logistics Center
ATTN: Contracts Committee
SA-ALC/PKC
143 Billy Mitchell Road
Kelly AFB, TX 78241-6014
04606 Sacramento Air Logistics Center
ATTN: PKPF
3237 Peacekeeper Way
Suite 17, McClellan AFB,
CA 95652-1060
09603 Warner Robins Air Logistics Center
ATTN: PKP
235 Byron Street
Robins AFB, GA 31098-1611
E-mail: dpadmin@pk.robins.af.mil

(Example: Contract F09603-C-82-0093 or AF 09(603)-001 would have been issued by the Warner Robins Air Logistics Center, AFLC, Code 09603.)

Defense Logistics Agency (DLA)

Distribute one additional copy of apparent defective pricing reports for contracting actions issued by the Defense Supply Centers and other DLA contracting offices only (not DCMAs or DPROs) to the following address:

HQ Defense Logistics Agency
ATTN: DLA-PPR
8725 John J. Kingman Rd.
Fort Belvoir, VA 22060-6219

10-700 Section 7 --- Audit Reports on Termination Settlement Proposals**10-701 Introduction (Termination Reports)**

a. This section provides guidance for preparing and distributing audit reports on contractors' termination settlement proposals. As used here, the term contractor includes subcontractor. Do not use the term offeror in audit reports related to termination settlements.

b. These reports furnish termination contracting officers (TCOs) information and audit recommendations to assist them in negotiating termination settlements with contractors. For reports covering a subcontractor's termination settlement proposal to a higher-tier contractor, include a statement on the subcontractor's agreement or disagreement with the release of the report to the higher-tier contractor in the Report Distribution and Restrictions section of the report.

c. A requestor may ask DCAA to evaluate limited portions of contractor termination settlement proposals by means of agreed-upon procedures. Agreed-upon procedures are appropriate when objective evaluation criteria exist and the auditor and requestor reach mutual agreement on the procedures to be applied. Guidance in 10-1000 should be followed, modified as necessary to conform to the requirements of termination reports. The auditor should ensure that:

- the acknowledgment indicates the parties have reached a clear understanding regarding the terms of the engagement in advance of initiation of the fieldwork (see 4-103.d.);
- the report does not refer to the engagement as an "audit";
- the report disclaims an opinion; and
- the restrictions are appropriate for agreed-upon procedures (see 10-1008).

10-702 Report Format and Contents (Termination Reports)

a. Prepare the report using the format given in 10-200. Address the report to the

TCO assigned responsibility for settlement of the contract. Include all pertinent information needed by the TCO to negotiate an equitable settlement.

b. The report will consist of a cover sheet, narrative section including exhibits and schedules, assembled as follows:

- Cover Sheet (10-205)
- Report Narrative (10-210)
- Subject of Audit (10-703)
- Executive Summary (10-704)
- Scope of Audit (10-705)
- Qualifications (10-210.4)
- Results of Audit (10-706)
- Opinion (10-706.1)
- Exhibits and Schedules (10-706.2)
- Additional Remarks (10-706.5)
- Contractor Organization and Systems (10-707)
- DCAA Personnel and Report Authorization (10-211)
- Report Distribution and Restrictions (10-708)
- Appendixes (10-308)
- Comments on Profit (or Fee)
- Fixed Price Contracts (12-307)
- Cost-Type Contracts (12-403)
- Assist Audit Reports
- Government Technical Reports

10-703 Subject of Audit (Termination Reports)

a. This part of the narrative will refer to the audit request, state the settlement proposal amount and whether it was submitted on the inventory or total cost basis. Also give summary information on the contract item, amount, and the status of completion when terminated if needed to understand the audit results.

b. Mention any aspects of the proposal emphasized during the audit at the express request of the contracting officer (12-202.d.). Include a statement that the submission is the responsibility of the contractor and that the auditor's responsibility is to express an opinion based on the audit or report our conclusions based on our evaluation (see 10-210.1b.(1)). Add other appropriate information as necessary.

10-704 Executive Summary (Termination Reports)

Develop an appropriate executive summary using the guidelines provided in 10-210.2 and 10-304.2.

10-705 Scope of Audit (Termination Reports)

a. Develop an appropriate scope of audit statement using the guidelines provided in 10-304.3. This statement will also include the applicable criteria of FAR Part 49. Place the scope statement as a separate paragraph after comments made about the purpose. Also describe the impact of the current assessment of control risk on the audit scope (10-210.3d). Include a statement that the termination settlement proposal costs were evaluated using the applicable requirements contained in:

- Federal Acquisition Regulation (FAR), including Part 49, Termination of Contracts;
- [*Agency's Supplement to the FAR, as appropriate*],
- [*Cost Accounting Standards (CAS), if applicable*]; and
- Contract Terms.

b. Qualifications. Identify any circumstances that adversely affect the audit, or its results, per 10-210.4. For example, if the auditor requested the government technical evaluation or inventory verification reports and these reports were not provided, this section of the audit report would include an explanation of the affect on the audit scope and results of not receiving this information.

10-706 Results of Audit (Termination Reports)

Follow the guidance in 10-210.5 and 10-304.5 when preparing this part of the report. However, modify the language to fit the circumstances of a termination settlement proposal. For example, add a reference to FAR Part 49 (contains the criteria for terminating contracts). If the terminated contract is CAS-covered, modify the reference to Public Law 91-

379 as necessary to conform with the exceptions noted in 12-104. Generally, a reference to "the practices required by applicable Cost Accounting Standards" will suffice.

10-706.1 Audit Opinion - Termination

Begin the Results of Audit section with the opinion paragraph. Follow the guidelines in 10-304.6.

10-706.2 Exhibits and Schedules

a. The Results of Audit section of the report should contain all exhibits and supporting schedules required for a clear and complete presentation of the audit results.

b. Follow the guidelines in 10-210.6 for preparing explanatory notes. Furnish the TCO enough information so he or she can clearly understand the basis of the amount proposed, the scope of the evaluation, and the recommendations for each cost element. Show the contractor's reaction to the recommendations, particularly for questioned costs.

c. Show the results of audit in exhibits and schedules using columns labeled "Questioned Costs" and "Unresolved Costs." Do not use the category "unsupported costs" and do not use a column for accepted costs. Where several items were improperly classified in the contractor's settlement proposal (e.g., an item proposed as "other cost" which is more properly an element of settlement expense), insert a reclassification column in the exhibit.

10-706.3 Questioned Costs

The criteria and guidance in 10-304.8b. for questioned costs also applies to termination settlement proposal evaluations. Comments such as "not necessary or incident to contract performance" or "excessive to contract requirements" require further explanation to adequately support a questioned cost.

10-706.4 Unresolved Costs

10-304.8d. states the criteria for this category. Due to the nature of termination

actions, this category may include items on which the auditor cannot reach a definitive conclusion. This is because it may be some time before the contractor's net cost or liability is firmly established (see 12-313).

Examples of these items are severance or dismissal pay and the cost of unexpired leases. FAR 49.109-2 requires the TCO to include an appropriate reservation in the settlement agreement for any items still unresolved at settlement.

10-706.5 Additional Remarks

Conclude the Results of Audit section of the report narrative with the following additional remarks, as appropriate:

a. Exit Conference (also see 10-210.5e.(1) and (2))

(1) State the date held and the name and title of the contractor's designated representative with whom the factual matters were discussed (see 4-304). Do not disclose the dollar impact of the findings.

(2) Include the contractor's reaction to factual differences and the major areas of difference likely to be pursued at negotiations. The summary might read as follows:

"We discussed the factual results of [audit or procedures, etc.] with [identify the contractor representative(s) by name and title] in an exit conference held on [date]. We did not provide the dollar impact of our findings. [Include a summary of the contractor's reaction, and the major areas likely to be pursued at negotiations, if any.] [If there was no response, the following is an example of a statement

that is permissible to include but not required.] [Identify contractor representative] reserved comment pending discussions with the Termination Contracting Officer."

b. Other Additional Remarks

Follow the guidelines provided in 10-210.5e. to prepare other additional remarks.

10-707 Contractor Organization and Systems (Termination Reports)

Include relevant information, which impacts the scope and the results of the termination audit. Tailor it to the contractor's size and where possible reference previous reports. Follow the guidelines in 10-210.7.

10-708 Distribution (Termination Reports)

a. Send the original and one copy of each audit report on a prime contract termination settlement proposal to the TCO. Furnish a copy when applicable to the onsite financial liaison advisor office servicing the TCO (refer to 15-3S1).

b. Address assist audit reports on sub-contract settlement proposals (original and two copies) to the auditor who made the request. On receipt, the requesting auditor will furnish the two copies to the TCO. These copies are either for his or her use, or if appropriate, for redistribution to the prime contractor or higher-tier subcontractor.

c. Furnish additional copies of the audit report as requested by the TCO.

10-800 Section 8 --- Audit Reports on Cost Accounting Standards Matters

10-801 Introduction (CAS Reports)

a. This section provides guidance for preparing and distributing audit reports related to Cost Accounting Standards (CAS). These reports furnish administrative contracting officers with information and audit recommendations to assist them in making CAS determinations.

b. Government Auditing Standards have incorporated Statements on Standards for Attestation Engagements (SSAE) in guidance covering fieldwork and reporting on financial related audits (see 2-100). Attestation standards (AT chapter 6) prohibit a review of an entity's compliance with laws or regulations. Accordingly, CAS evaluations must be performed and reported upon as an examination (as opposed to a review) under the Attestation Standards, with the objective of expressing an opinion on the implied assertion that the entity has complied with applicable CAS Board rules, regulations, and standards.

10-802 Nature of Reports (CAS Reports)

There are six basic types of CAS related reports. They are:

- (1) reports on the adequacy of initial disclosure statements,
- (2) reports on the compliance of initial disclosure statements,
- (3) reports concerning adequacy and compliance of disclosure statement revisions,
- (4) reports on CAS compliance audits,
- (5) reports on CAS noncompliances, and
- (6) reports on cost impact proposals.

Except for reports on noncompliances and CAS compliance audits, CAS reports are usually prepared in response to an audit request received from the cognizant Federal agency official (CFAO). The CFAO is the contracting officer assigned by the cognizant Federal agency to administer CAS. Within DoD, the CFAO is the cognizant administrative contracting officer (ACO).

10-803 Report Format and Content (CAS Reports)

a. Prepare the report following the guidance in 10-200, supplemented by this section. Address the reports to the CFAO. They should contain sufficient information for the CFAO to determine, as appropriate, (1) disclosure statement adequacy or inadequacy, (2) noncompliance of the disclosure statement with CAS or FAR, (3) CAS noncompliance during contract performance or proposal submission, and (4) any necessary contract price adjustments. The report formats included in this section are intended to reduce report writing effort and increase uniformity in report presentation among FAOs.

b. Assemble reports on CAS matters as follows:

Cover Sheet (10-205)

Report Narrative (10-210)

Subject of Audit (10-210.1)

Executive Summary (10-210.2)

Scope of Audit (10-210.3)

Qualifications (10-210.4)

Statement of Changes (10-806)

Results of Audit (10-210.5)

Opinion/Disclaimer (10-804.5b.)

Exhibits and Schedules, as appropriate

Statement of Conditions and Recommendations

Cost Impact (10-806)

Additional Remarks

Contractor Organization and Systems

DCAA Personnel and Report Authorization (10-211)

Report Distribution and Restrictions (10-212)

Appendixes (as necessary)

The format and content for each of the six basic types of CAS related reports are discussed in the following paragraphs.

10-804 Audit Reports - Adequacy of Initial Disclosure Statement (Disclosure Statement Reports)

These reports are intended to inform the CFAO whether the contractor's initial sub

mission of its disclosure statement adequately describes the contractor's cost accounting system. The title of this type of report should be "Report on Adequacy of Initial Disclosure Statement Dated [date]" (subject line of cover sheet).

10-804.1 Subject of Audit

Include the following statements in this paragraph:

"By submitting a CAS disclosure statement, [*entity name (short name)*] asserts that its disclosed cost accounting practices adequately describe the practices used to estimate, accumulate, and report costs incurred or to be incurred on government contracts covered by 48 C.F.R. Chapter 99. The purpose of our examination was to evaluate whether the subject disclosure statement adequately describes the cost accounting practices which the contractor proposes to use in the performance of government contracts covered by 48 C.F.R. Chapter 99.

The disclosure statement and related data are the responsibility of the contractor. Our responsibility is to express an opinion on the adequacy of the disclosure statement based on our examination."

10-804.2 Executive Summary

Develop an appropriate Executive Summary using the guidelines provided in 10-210.2 and 10-304.2.

10-804.3 Scope of Audit

Include the following scope statement in this paragraph:

"We conducted our examination in accordance with generally accepted government auditing standards. Those standards require that we plan and perform the examination to obtain reasonable assurance about whether the contractor's disclosure statement adequately describes its

cost accounting practices. An examination includes:

- evaluating the contractor's internal controls, assessing control risk, and determining the extent of audit testing needed based on the control risk assessment;
- examining, on a test basis, evidence supporting the adequacy of the disclosure statement; and
- evaluating the overall disclosure statement presentation.

We evaluated the subject disclosure statement using the applicable requirements contained in the:

- Federal Acquisition Regulation (FAR); and
- CAS Board rules, regulations and standards."

The next paragraph in the Scope section should describe the impact of the current assessment of control risk (Environment and Overall Accounting Controls) on the audit scope (see 10-210.3). As required by AT 6.55g, end the Scope section with the following statement:

"Our examination does not provide a legal determination on [*short name's*] compliance with the specified requirements."

10-804.4 Qualifications

Separately identify and describe any special circumstances or conditions adversely affecting the audit or its result.

10-804.5 Results of Audit

a. Opinion. This section of the report presents an opinion regarding the adequacy of the disclosure statement. Examples of optional statements are provided below:

- (1) "In our opinion, the subject disclosure statement adequately describes the contractor's cost accounting practices."

(2) “In our opinion, the subject disclosure statement, amended by pages dated ___, adequately describes the contractor’s cost accounting practices.”

(3) “In our opinion, the subject disclosure statement does not adequately describe the contractor’s cost accounting practices. Accordingly, we recommend the contractor be requested to submit a revised disclosure statement.”

b. Disclaimer. The section will also include the following report disclaimer:

“This examination was limited to evaluating the adequacy of accounting practice descriptions in the subject disclosure statement. Accordingly, we express no opinion on whether the disclosed practices are proper, approved, or agreed to for pricing proposals, accumulating costs, or reporting contract performance data.”

c. Statement of Conditions and Recommendations. When the disclosure statement is considered inadequate, use this paragraph to present the statement shown below:

“We identified the following inadequacies in the contractor’s disclosure statement:”

Each inadequacy should then be identified to the disclosure statement item number and explained sufficiently to permit a thorough understanding of the problem. The report should include a recommendation for corrective action and the contractor’s comments about the condition and recommendation.

d. Additional Remarks. Provide concluding remarks at the end of the Results of Audit section, as discussed in 10-210.5e. Provide a summary of the exit conference. The summary might read as follows:

“We discussed the results of our examination with [*identify the contractor representative(s) by name and title*] in an exit conference held on [*date*]. [*If there were adverse findings*] In response to our findings,

[*provide the contractor’s reaction, if any.*] [*If there was no response, the following is an example of a statement that is permissible but not required.*] [*Identify the contractor representative*] reserved comment pending discussions with the cognizant Federal agency official.”

10-804.6 Contractor Organization and Systems

Use this section to provide any supplementary data on the contractor’s operations necessary to permit a better understanding of the circumstances surrounding any reported condition and recommendation. Refer to 10-210.7 for general guidance on preparing this section.

10-804.7 Report Distribution and Restrictions - Adequacy

Refer to the guidance provided in 10-810 for report distribution and release restrictions.

10-805 Audit Reports – Compliance of Initial Disclosure Statement (Disclosure Statement Reports)

These reports are intended to inform the CFAO whether the accounting practices disclosed in the contractor’s initial submission of its disclosure statement comply with CAS and FAR Part 31. The title of this type of report should be “Report on Compliance of Initial Disclosure Statement Dated (*date*)” (subject line of cover sheet).

10-805.1 Subject of Audit

Include the following statements in this paragraph:

“By submitting its CAS disclosure statement, [*contractor’s name*] asserts that the disclosure statement adequately describes its cost accounting practices, and the disclosed practices comply with Cost Accounting Standards Board rules, regulations, and standards contained in 48 C.F.R. Chapter 99. The purpose of our ex-

amination was to determine whether the disclosed practices described in [contractor name]'s disclosure statement [date] comply with applicable Cost Accounting Standards and FAR Part 31.

The contractor is responsible for the disclosure statement and compliance of the disclosed accounting practices with applicable Cost Accounting Standards and FAR Part 31. Our responsibility is to express an opinion on the adequacy of the disclosure statement and whether the disclosed accounting practices comply with those requirements based on our examination."

10-805.2 Executive Summary

Develop an appropriate Executive Summary using the guidelines provided in 10-210.2 and 10-304.2.

10-805.3 Scope of Audit

Include the following scope statement in this paragraph:

"We conducted our examination in accordance with generally accepted government auditing standards. Those standards require that we plan and perform the examination to obtain reasonable assurance about whether the contractor has complied with the requirements referred to above. An examination includes:

- evaluating the contractor's internal controls, assessing control risk, and determining the extent of audit testing needed based on the control risk assessment;
- examining, on a test basis, evidence relating to the descriptions of the proposed cost accounting practices; and
- assessing whether the described practices comply with applicable requirements.

We evaluated the contractor's disclosure statement using applicable requirements contained in the:

- Federal Acquisition Regulation (FAR); and
- CAS Board rules, regulations and standards."

The next paragraph in the Scope section should describe the impact of the current assessment of control risk (Environment and Overall Accounting Controls) on the audit scope (see 10-210.3). As required by AT 6.55g, end the Scope section with the following statement:

"Our examination does not provide a legal determination on [short name's] compliance with the specified requirements."

10-805.4 Qualifications

Separately identify and describe any special circumstances or conditions adversely affecting the audit or its result.

10-805.5 Results of Audit

Begin this section with an opinion statement on the compliance of the described practices. Examples of optional statements are provided below:

(1) The disclosed practices, as described, are compliant.

"In our opinion, the disclosed cost accounting practices comply with applicable Cost Accounting Standards, and FAR Part 31. We have not tested the actual practices for compliance with FAR and CAS, and accordingly, we express no opinion on the contractor's actual compliance with the regulations."

(2) The disclosed practices, as described, are noncompliant.

"In our opinion, certain of the contractor's disclosed practices are in non-compliance with [insert CAS number(s) and/or specific FAR Part 31 reference]. The details of the noncompliance(s) have been reported separately in audit report number [insert report number]."

(3) The disclosed practices are compliant with CAS and FAR Part 31. Although the audit scope is limited to compliance of the disclosed practices with CAS and FAR Part 31, DCAA may be aware through other audit work that an actual-practice is noncompliant with the disclosed practice. In this case, the following language should be used.

“In our opinion, the contractor’s cost accounting practices, as described, comply with applicable Cost Accounting Standards and FAR Part 31. Although the audit scope is limited to *compliance* of the disclosed practices with CAS and FAR Part 31, we are aware that the contractor’s actual cost accounting practices [*identify area of noncompliance*] are not consistent with disclosed practices and are in noncompliance with [*identify CAS or FAR requirement violated*]. Details of the noncompliance(s) have been reported separately in [*insert report number*].”

10-805.6 Contractor Organization and Systems

Use this section to provide any supplementary data on the contractor’s operations necessary to permit a better understanding of the circumstances surrounding any reported condition and recommendation. Refer to 10-210.7 for general guidance on preparing this section.

10-805.7 Report Distribution and Restrictions – Compliance

Refer to the guidance provided in 10-810 for report distribution and release restrictions.

10-806 Audit Reports on Concurrent Adequacy and Compliance Audits of Revised Disclosure Statements (Concurrent CAS Reports)

Use the report format described below for reporting on accounting practice changes where a disclosure statement revision was submitted, or where no disclosure statement is required. In the latter

instance the proposed established accounting practice change should be referenced instead of references to disclosure statement revisions in 10-806.1, 10-806.4a., 10-806.6a., and 10-806.8a.

10-806.1 Subject of Audit

Examples of purpose statements are provided below (use 1 & 2 for audits requested by the contracting officer; use only 2 for self-initiated audits):

(1) “In response to your (*date*) request, Case No. __, we examined the (*Contractor name*)’s revised disclosure statement (*date*).”

(2) “By submitting its revised CAS disclosure statement, [*contractor’s name*] asserts that the disclosure statement adequately describes its cost accounting practices, and the disclosed practices comply with Cost Accounting Standards Board rules, regulations, and standards contained in 48 C.F.R. Chapter 99. The purpose of our examination was to determine whether (*Contractor name*)’s revised disclosure statement (*date*) adequately describes the cost accounting practices that the contractor proposes to use in performing government contracts covered by 48 C.F.R. Chapter 99, and whether the revised practices comply with applicable Cost Accounting Standards and FAR Part 31. [*If the audit included the steps to test compliance with actual practices, add*] We also evaluated the consistency of the revised cost accounting practices with actual practices.”

“The contractor is responsible for the disclosure statement and compliance of the disclosed accounting practices with applicable Cost Accounting Standards and FAR Part 31. Our responsibility is to express an opinion on the adequacy of the disclosure statement and whether the disclosed accounting practices comply with those requirements based on our examination.”

10-806.2 Executive Summary

Develop an appropriate Executive Summary using the guidelines provided in 10-210.2 and 10-304.2

10-806.3 Scope of Audit

a. Insert the following paragraph in both contracting officer requested and self-initiated audits:

“We conducted our examination in accordance with generally accepted government auditing standards. Those standards require that we plan and perform the examination to obtain reasonable assurance about whether the contractor has complied with the requirements referred to above. An examination includes:

- evaluating the contractor's internal controls, assessing control risk, and determining the extent of audit testing needed based on the control risk assessment;
- examining, on a test basis, evidence relating to the descriptions of the proposed cost accounting practices;
- assessing the descriptions of the revised cost accounting practices proposed and determining whether they describe practices which, when implemented, should be compliant with applicable requirements; and
- evaluating the overall disclosure statement presentation.

We evaluated the contractor's revised disclosure statement using applicable requirements contained in the:

- Federal Acquisition Regulation (FAR); and
- CAS Board rules, regulations and standards.”

b. The next paragraph in the scope section should describe the impact of the current assessment of control risk (Environment and Overall Accounting Controls) on the examination scope (see 10-210.3). As re-

quired by AT 6.55g, end the Scope section with the following statement:

“Our examination does not provide a legal determination on [*short name's*] compliance with the specified requirements.”

10-806.4 Qualifications

Separately identify and describe any special circumstances or conditions adversely affecting the audit or its result.

10-806.5 Statement of Changes

a. Use this paragraph to state the change, along with the effective date of the change, on which the revision to the contractor's disclosure statement is based. For example, the paragraph may read:

“The subject disclosure statement revision reflects the following change to the contractor's accounting practices (*or operations, organization, etc.*), and is effective on [*date*] (*or on the dates noted below:*).”

b. The paragraph should also contain an appropriate reference to the procedures prescribed in the FAR clause for disclosure statement revisions. Examples of statements are provided below:

(1) “The change(s) results from implementing a new Cost Accounting Standard and is therefore subject to negotiation with the CFAO for an equitable adjustment under FAR 52.230-2(a)(4)(i).”

(2) “The unilateral change(s) has not been agreed to by the contracting parties. Terms and conditions are therefore subject to negotiation with the CFAO under FAR 52.230-2(a)(4)(ii).”

(3) “The desirable change(s) agreed to by the contracting parties is subject to negotiation with the CFAO for an equitable adjustment under FAR 52.230-2(a)(4)(iii).”

(4) “The change(s) results from the contractor's agreement with, and correction of, a previously determined noncompliant condition, and is, therefore, subject to government recovery of increased costs together with interest under FAR 52.230-2(a)(5).”

10-806.6 Results of Audit

a. Opinion. This paragraph presents an opinion on the adequacy and compliance of the disclosure statement revision. Examples of optional statements are provided below:

(1) The description is adequate and the disclosed practices are compliant.

“In our opinion, the subject revision adequately describes the contractor's revised cost accounting practices. The practices, as described, comply with applicable Cost Accounting Standards, and FAR Part 31. The revision is effective as of [date]. Because the contractor has not implemented the revised practices, as of [date fieldwork completed], we have had no opportunity to observe whether the contractor complies with the revised practices, and accordingly we express no opinion on the contractor's compliance with the revised practices.”

[If the examination included steps to test compliance with actual practices.]

“In our opinion, the subject revision adequately describes the contractor's revised cost accounting practices. The practices, as described, comply with applicable Cost Accounting Standards and FAR Part 31 and are consistent with the contractor's actual practices.”

(2) The description is inadequate and DCAA has not evaluated its compliance.

“In our opinion the subject disclosure statement revision does not adequately describe the contractor's revised cost accounting practices. Accordingly, we recommend the contractor be re-

quested to submit a revised disclosure statement.

Because of the significant inadequacies, we were unable to evaluate the disclosure statement revision for compliance with applicable Cost Accounting Standards and FAR Part 31. Accordingly, we express no opinion on the compliance with CAS and FAR Part 31.”

(3) The description is adequate but one or more disclosed practices are noncompliant.

“In our opinion, the subject revision adequately describes the contractor's revised cost accounting practices. However, during our examination we identified certain of the contractor's disclosed practices which, we believe are in noncompliance with [insert CAS number(s) and/or specific FAR Part 31 reference]. The details of the noncompliance(s) have been reported separately in audit report number [insert report number].”

(4) The description is inadequate in part and the adequately disclosed portion contains noncompliant practices.

“In our opinion, the subject disclosure statement revision (*amendment*) does not adequately describe the contractor's revised cost accounting practices. Accordingly, we recommend the contractor be requested to submit a revised disclosure statement. Also, during our examination we identified certain of the contractor's revised practices which, we believe are in noncompliance with [insert CAS number(s) and/or specific FAR Part 31 reference]. The details of the noncompliance(s) have been reported separately in audit report number [insert report number].”

(5) The description is adequate and the disclosed practices are compliant. DCAA has noted that the contractor's actual practices are noncompliant.

“In our opinion, the subject revision adequately describes the contractor's revised cost accounting practices. The practices, as described, comply with applicable Cost Accounting Standards and FAR Part 31. However, during our examination we noted that the contractor's actual cost accounting practices [*identify area of noncompliance*] are not consistent with disclosed practices and are in noncompliance with [*identify CAS or FAR requirement violated*]. Details of the noncompliance(s) have been reported separately in [*insert report number*].

b. Statement of Conditions and Recommendations. This paragraph, applicable whenever inadequacies were found, should begin with the following statement.

“We identified the following inadequacies in the contractor's revised disclosure statement.”

List each inadequacy item separately with the type of information cited in 10-804.5c.

c. Cost Impact. The paragraph should contain an estimate of the cost impact, if available, and a reminder to the CFAO to obtain a cost impact statement when the cost impact is material (FAR 30-602). To do this, start this paragraph with the following statement:

“The contractor is responsible for submitting cost impact proposals and for engaging in negotiations of adjustments resulting from changes to disclosed accounting practices. A cost impact proposal should contain sufficient detail to permit evaluation and negotiation of the effect upon each contract and subcontract containing the CAS clause. It shall contain as a minimum the following information:

(1) identification of all contracts and subcontracts containing the CAS clause; and

(2) the effect (including cost, profit/fee, price/amount) on each contract and subcontract from the effective date of the change until

completion of the contract or subcontract.”

“It is not practical to estimate the magnitude of the total cost impact for the change(s) in the revision prior to your obtaining this information from the contractor. However, in the way of a partial estimate. . . . (*Include an estimate of the cost impact or delete the last sentence if the auditor is unable to provide a partial estimate and instead explain why an estimate could not be provided.*)”

When there is increased cost to the government because of a unilateral change that is subject to the provisions of FAR 52.230-2(a)(4)(ii), the following should be included:

“We estimate the increased cost to the government because of the change to be \$ _____. However, any agreement which would result in net increased cost to the government would be contrary to the provisions of FAR 52.230-2(a)(4)(ii).”

d. Additional Remarks. Provide concluding remarks at the end of the Results of Audit section, as discussed in 10-210.5e. Provide a summary of the exit conference. The summary might read as follows:

“We discussed the results of our examination with [*identify the contractor representative(s) by name and title*] in an exit conference held on [*date*]. [*If there were adverse findings*] In response to our findings, [*provide the contractor's reaction, if any.*] [*If there was no response, the following is an example of a statement that is permissible but not required.*] [*Identify the contractor representative*] reserved comment pending discussions with the cognizant Federal agency official.”

10-806.7 Contractor Organization and Systems

Use this section to provide supplementary data on the contractor's operations as

necessary for a better understanding of the circumstances surrounding any reported disclosure statement inadequacy or instance of noncompliance and the auditor's recommendation. Such data should not duplicate information already submitted in earlier reports. Refer to 10-210.7 for general guidance on preparing this section.

10-806.8 Report Distribution and Restrictions - Concurrent

Refer to the guidance provided in 10-810 for report distribution and release restrictions.

10-807 CAS Compliance Audit Reports (CAS Compliance Reports)

Use this report format when no instances of noncompliances are found during CAS compliance audits. If noncompliances are found, issue a memo to the file and close this assignment (194XX). Noncompliance(s) should be reported under the 19200 assignment code, following the noncompliance report format (see 10-808).

10-807.1 Subject of Audit

This section identifies the contractor's implied assertion and responsibility regarding CAS compliance. It also identifies the purpose of the audit and the period covered by the audit. Generally, a contractor's cost accounting practices related to each standard should be audited comprehensively as a single audit assignment. A limited scope audit should be performed only when it is not practical to audit all of the accounting practices related to the standard at once (e.g., too many significant pools to audit). If the audit was limited to a certain area(s) of the contractor's cost accounting practices (e.g., 3 indirect pools audited from 7 significant pools maintained by the contractor), this section should clearly identify the limited areas audited. The subject of audit paragraph may read:

"By performing government contracts covered by 48 C.F.R. Chapter 99, [entity name (short name)] asserts that it has complied with the requirements of Cost Accounting Stan-

dards. The purpose of our examination was to determine if the contractor complied with the requirements of CAS [number and title of standard(s)], and any applicable FAR Part 31 requirements, [if applicable, include "in accounting for [identify the specific area(s) audited]"] during the period of [insert the period covered by the audit]. The contractor is responsible for compliance with the requirements of this standard. Our responsibility is to express an opinion on compliance with those requirements based on our examination."

10-807.2 Scope of Audit

Include the following scope statement in this paragraph:

"[If applicable, include, "We limited our audit to an examination of the contractor's cost accounting practices related to [identify specific area(s) examined.]"] We conducted our examination in accordance with generally accepted government auditing standards. Those standards require that we plan and perform the examination to obtain reasonable assurance that the contractor's accounting practices comply with the requirements referred to above. An examination includes:

- evaluating the contractor's internal controls, assessing control risk, and determining the extent of audit testing needed based on the control risk assessment;
- examining, on a test basis, evidence supporting the cost accounting practices; and
- assessing the actual cost accounting practices and compliance of those practices with disclosed cost accounting practices and applicable requirements.

We evaluated the contractor's cost accounting practices using the applicable requirements contained in the:

- Federal Acquisition Regulation (FAR), and

- CAS Board rules, regulations and standards.”

The next paragraph in the Scope section should describe the impact of the current assessment of control risk (Environment and Overall Accounting Controls) on the audit scope (see 10-210.3). As required by AT 6.55g, end the Scope section with the following statement:

“Our examination does not provide a legal determination on [*short name*’s] compliance with the specified requirements.”

10-807.3 Qualifications

Separately identify and describe any special circumstances or conditions adversely affecting the audit or its result.

10-807.4 Results of Audit

a. Include the following opinion in this paragraph:

“In our opinion, [*name*] complied, in all material respects, with the requirements of Cost Accounting Standard(s) [*number(s) and title(s) of standard(s)*] [*if applicable, include “in accounting for [identify the specific area(s) audited]”*] during the period of [*insert the period covered by the audit*].”

b. Additional Remarks. Provide concluding remarks at the end of the Results of Audit section, as discussed in 10-210.5e. Provide a summary of the exit conference. The summary might read as follows:

“We discussed the results of our examination with [*identify the contractor representative(s) by name and title*] in an exit conference held on [*date*].”

10-807.5 Report Distribution and Restrictions - Compliance

Refer to the guidance provided in 10-810 for report distribution and release restrictions.

10-808 Audit Reports on Noncompliance with Disclosed or Established Practices, CAS, or FAR (Noncompliance Reports)

All instances of noncompliance will be reported separately regardless of the assignment under which they were found. Use a 19200 assignment to report and resolve the noncompliance(s) found in other assignments (see 8-302.7c.).

10-808.1 Subject of Audit

Examples of statements applicable to noncompliances found are provided below:

a. The following is an example of a paragraph to use when a noncompliance is found during an audit of the disclosure statement:

“By submitting a CAS disclosure statement, [*entity name (short name)*] asserts that its disclosed cost accounting practices used to estimate, accumulate, and report costs incurred or to be incurred on government contracts comply with Cost Accounting Standards Board rules, regulations, and standards appearing in 48 C.F.R. Chapter 99. We examined the subject disclosure statement to evaluate whether the disclosed cost accounting practices comply with the CAS Board rules, regulations, and standards. We also examined the disclosed practices to evaluate whether they comply with applicable FAR Part 31 requirements. The contractor is responsible for compliance with CAS and FAR requirements. Our responsibility is to express an opinion on compliance based on our examination.”

b. The following is an example of paragraphs to use when noncompliance is found during contract performance (use (1) if noncompliance is found during CAS compliance audits, use (2) for noncompliance found during other audits):

(1) “By performing government contracts covered by 48 C.F.R. Chapter 99, [*entity name (short name)*] asserts that its cost accounting practices

comply with the CAS Board rules, regulations, and standards. The purpose of the examination was to determine if the contractor has complied with the requirements of CAS [*number(s) and title(s) of standard(s) and any applicable FAR Part 31 requirements*] [*if applicable, include “in accounting for [identify specific area(s) audited]”*]. The contractor is responsible for compliance with the CAS and FAR requirements. Our responsibility is to express an opinion on compliance based on our examination.”

(2) “By performing government contracts covered by 48 C.F.R. Chapter 99, [*entity name (short name)*] asserts that its cost accounting practices comply with the CAS Board rules, regulations, and standards. Our continuous examination of the contractor's cost accounting practices during performance of contracts includes evaluating whether the contractor has complied with the CAS Board rules, regulations, and standards, and any applicable FAR Part 31 requirements. The contractor is responsible for compliance with those requirements. Our responsibility is to express an opinion on compliance based on our examination.”

c. The following is an example of a paragraph to use when noncompliance is found during a proposal evaluation:

“By submitting a proposal for a government contract covered by 48 C.F.R. Chapter 99, [*entity name (short name)*] asserts that the cost accounting practices used in the proposal comply with the CAS Board rules, regulations, and standards [*and its disclosed practices, if D/S filed*]. Our examination of the contractor's cost accounting practices during proposal evaluations includes evaluating whether the contractor has complied with the CAS Board rules, regulations, and standards, and FAR Part 31. The contractor is responsible for compliance with those requirements. Our responsibility is to express an opinion on compliance with those re-

quirements based on our examination.”

10-808.2 Executive Summary

Develop an appropriate Executive Summary using the guidelines provided in 10-210.2 and 10-304.2.

10-808.3 Scope of Audit

Examples of statements applicable to noncompliances are provided below:

a. The following is an example of a paragraph to use when a noncompliance is found during an audit of the disclosure statement.

“We conducted our examination in accordance with generally accepted government auditing standards. Those standards require that we plan and perform the examination to obtain reasonable assurance about whether the contractor has complied with the requirements referred to above. An examination includes:

- evaluating the contractor's internal controls, assessing control risk, and determining the extent of audit testing needed based on the control risk assessment;
- examining, on a test basis, evidence supporting the cost accounting practices;
- assessing the descriptions of the cost accounting practices which, when implemented, should be compliant with applicable requirements; and
- evaluating the overall disclosure statement presentation.

We evaluated the contractor's cost accounting practices using the applicable requirements contained in the:

- Federal Acquisition Regulation (FAR); and
- CAS Board rules, regulations and standards.”

b. The following is an example of a paragraph to use when noncompliance is found during contract performance.

“[If applicable (i.e., limited scope CAS compliance audit), include, “We limited our audit to an examination of the contractor’s cost accounting practices related to [identify specific area(s) examined.]”] We conducted our examination in accordance with generally accepted government auditing standards. Those standards require that we plan and perform the examination to obtain reasonable assurance about whether the contractor has complied with the requirements referred to above. An examination includes:

- evaluating the contractor’s internal controls, assessing control risk, and determining the extent of audit testing needed based on the control risk assessment;
- examining, on a test basis, evidence supporting the cost accounting practices; and
- assessing the actual cost accounting practices and compliance of those practices with the disclosed cost accounting practices and applicable requirements.

We evaluated the contractor’s cost accounting practices using the applicable requirements contained in the:

- Federal Acquisition Regulation (FAR); and
- CAS Board rules, regulations and standards.”

c. The following is an example of a paragraph to use when noncompliance is found during a proposal evaluation:

“We conducted our examination in accordance with generally accepted government auditing standards. Those standards require that we plan and perform the examination to obtain reasonable assurance about whether the proposal complies with the requirements referred to above. An examination includes:

- evaluating the contractor’s internal controls, assessing control risk, and determining the extent of audit testing needed based on the control risk assessment;

- examining, on a test basis, evidence supporting the cost accounting practices;
- assessing the cost accounting practices used in estimating and compliance of those practices with the disclosed and/or established cost accounting practices and applicable requirements; and
- evaluating the overall proposal presentation.

We evaluated the contractor’s cost accounting practices using the applicable requirements contained in the:

- Federal Acquisition Regulation (FAR); and
- CAS Board rules, regulations and standards.”

d. The next paragraph in the scope section should describe the impact of the current assessment of control risk (Environment and Overall Accounting Controls) on the audit scope (see 10-210.3 and 10-304.3c.). As required by AT 6.55g, end the Scope section with the following statement:

“Our examination does not provide a legal determination on [*short name’s*] compliance with the specified requirements.”

10-808.4 Qualifications

Separately identify and describe any special circumstances or conditions adversely affecting the audit or its result.

10-808.5 Results of Audit

a. Opinion. This paragraph presents a summary statement of the noncompliance(s) being reported. An example follows:

“In our opinion, during this period (*state period covered by the audit*) the contractor was in noncompliance with CAS 401, CAS 412, and FAR 31.205-6(j). As of the date of this report, the condition causing the noncompliance has not been corrected.”

b. The paragraph will include the following report qualification:

“This report is limited to the cited instance(s) of noncompliance. Accordingly, we express no opinion on whether other practices are proper, approved, or agreed to for pricing proposals, accumulating costs, or reporting contractor performance data.”

c. Statement of Conditions and Recommendations. The paragraph should begin with one of the following statements:

(1) “Our examination identified a disclosed (*or established*) contractor practice which we believe is in non-compliance with the cost accounting standards and/or FAR Part 31, as follows:”, or

(2) “Our examination disclosed that the contractor's failure to comply with a cost accounting standard (*and/or failure to follow consistently a disclosed cost accounting practice*) has resulted or may result in increased cost paid by the government. The areas of noncompliance and/or failure to follow disclosed practices are stated below:”

d. Separately list each noncompliance item, with the following information:

(1) A sufficient identification and description of the noncompliance to permit a thorough understanding of the situation. Cite the specific CAS or FAR provision violated.

(2) An explanation of the significance of the problem.

(3) A specific recommendation for corrective action with a statement about any acceptable alternative solutions proposed by the contractor.

(4) A statement regarding the contractor's responsibilities under the CAS administration clause at FAR 52.230-6. This clause requires the contractor to submit a description of any cost accounting change or a revised disclosure statement, if applicable, and a general dollar magnitude submission for noncompliance with a CAS or a disclosed practice to the cognizant Federal agency official.

(5) The contractor's reaction to the issue.

(6) Auditor comments on the contractor's reaction and/or response.

e. Additional Remarks. Provide additional remarks at the end of the Results of Audit section, as discussed in 10-210.5e. Provide a summary of the exit conference. The summary might read as follows:

“We discussed the results of our examination with [*identify the contractor representative(s) by name and title*] in an exit conference held on [*date*]. In response to our findings, [*provide contractor's reaction, if any.*] [*If there was no response, the following is an example of a statement that is permissible but not required.*] [*Identify the contractor representative*] reserved comment pending discussions with the cognizant Federal agency official.”

10-808.6 Contractor Organization and Systems

Use this section to provide any supplementary data on the contractor's operations necessary for a better understanding of the circumstances surrounding any reported noncompliance and the auditor's recommendations. Such data should not duplicate information already submitted in earlier reports. Refer to 10-210.7 for general guidance on preparing this section.

10-808.7 Report Distribution and Restrictions - Noncompliance

Refer to the guidance provided in 10-810 for report distribution and release restrictions.

10-809 Cost Impact Statements (CAS Cost Impact Reports)

This section describes the format for audit reports on evaluations of cost impact statements.

10-809.1 Subject of Audit

a. This paragraph should reference the audit request, other related audit reports

(e.g., noncompliance reports), and any other documents, which contain pertinent information about the contractor's cost impact submission. The information contained in the referenced documents should not be duplicated in the cost impact evaluation report. Also reference the date of the contractor's cost impact statement and the effective date of the changed accounting practice, which resulted in the cost increases or decreases. The changed accounting practice should be described and categorized as either a:

(1) Required change resulting from either the implementation of a new standard or a prospective change from one compliant practice to another that is necessary for the contractor to remain in compliance (equitable adjustment),

(2) Unilateral change which is not deemed desirable by the contracting officer (no increased costs to the government),

(3) Desirable change, which was deemed desirable and not detrimental to the government (equitable adjustment).

(4) Change resulting from the correction of a CAS noncompliance, or

b. An example of an acceptable statement follows:

"As requested by your September 30, 20XX letter, we examined the XYZ Corporation August 31, 20XX cost impact proposal reflecting the contractor's unilateral accounting change to combine the engineering and logistics overhead pools, effective November 1, 20XX. Since the CFAO has not determined that the accounting change is desirable, it is subject to the provisions of FAR 52.230-2(a)(4)(ii).

The cost impact proposal and related supporting data are the responsibility of the contractor. Our responsibility is to express an opinion on the cost impact proposal based on our examination."

10-809.2 Executive Summary

Develop an appropriate Executive Summary using the guidelines provided in 10-210.2 and 10-304.2.

10-809.3 Scope of Audit

a. Insert the following paragraph:

"Except for the qualifications below [*omit if there are no 'Qualifications' in the report*], we conducted our examination in accordance with generally accepted government auditing standards. Those standards require that we plan and perform the examination to obtain reasonable assurance about whether the cost impact proposal is free of material misstatement. An examination includes:

- evaluating the contractor's internal controls, assessing control risk, and determining the extent of audit testing needed based on the control risk assessment;
- examining, on a test basis, evidence supporting the amounts and disclosures in the cost impact proposal;
- assessing the accounting principles used and significant estimates made by the contractor; and
- evaluating the overall cost impact proposal presentation.

We evaluated the contractor's cost impact proposal using the applicable requirements contained in the:

- Federal Acquisition Regulation (FAR) 30.6; and
- CAS Board Rules and Regulations, 48 CFR 9903.306."

b. The next paragraph in the scope section should describe the impact of the current assessment of control risk (Environment and Overall Accounting Controls) on the audit scope (see 10-210.3e.).

10-809.4 Qualifications

Separately identify and describe any special circumstances adversely affecting the audit or its result. Add any qualification as to the completeness and accuracy of the universe of CAS-covered contracts.

10-809.5 Results of Audit

a. Begin this paragraph with an opinion statement on the adequacy of the data sub-

mitted by the contractor. As an example, the report could read:

“Although not adequate in part (see comments on page __, note __), in our opinion, the contractor has submitted data which are acceptable for negotiating the cost impact due to the unilateral change.”

The paragraph should comment on whether increased costs to the government resulted and refer to the report exhibit for details. (See Figure 10-8-1.)

b. Exhibits and Schedules. The Results of Audit section of the report should contain all exhibits and supporting schedules required for a clear and complete presentation of the audit results and recommendations on all items in the proposed cost impact statement. They should include as a minimum the following information:

(1) A schedule of contracts by type, showing proposed impact on cost, profit/fee, and price/amount.

(2) An audit recommendation on cost impact for each contract. If totals are shown, indicate that they are for general information only and do not represent a recommendation regarding offsets or profit/fee adjustments.

(3) Separate schedules showing detail for cost impact computations.

(4) Comments on profit and offsets but not specific recommendations.

(5) Contractor comments.

c. Additional Remarks. Provide concluding remarks at the end of the Results of Audit section, as discussed in 10-210.5e. Provide a summary of the exit conference. The summary might read as follows:

“We discussed the results of our examination with [*identify the contractor representative(s) by name*

and title] in an exit conference held on [*date*]. [*If there were adverse findings*] In response to our findings, [*provide the contractor’s reaction, if any.*] [*If there was no response, the following is an example of a statement that is permissible but not required. (Identify the contractor representative)*] reserved comment pending discussions with the cognizant Federal agency official.]”

10-809.6 Contractor Organization and Systems

Use this section to provide supplementary data on the contractor's operations to improve the understanding of the circumstances surrounding any reported condition or the auditor's recommendation.

Refer to 10-210.7 for general guidance on preparing this section.

10-809.7 Report Distribution and Restrictions – CAS Cost Impact

Refer to the guidance in 10-810 for report distribution and release restrictions.

10-810 Distribution and Restrictions

a. Furnish copies of CAS audit reports to non-DoD agencies as noted in 15-1S6.

b. Furnish the CAC/CHOA/GAC copies of all CAS audit reports as provided in 15-200.

c. Furnish the region copies of CAS audit reports following the procedures established by the region.

d. Refer to the guidance provided in 10-212 for general requirements for the report distribution and release restrictions.

Figure 10-8-1
Statement of Contractor's Proposed
Contract Price Adjustments
For

- (A) The Implementation of CAS ____
 (B) A Unilateral Change in Cost Accounting Practice
 (C) Noncompliance with CAS ____
 (D) Noncompliance with Disclosed Cost Accounting Practice
 (E) Noncompliance with CAS ____ and Disclosed Accounting
 Practice and Results of Audit

CONTRACT/SUBCONTRACT	<u>CONTRACTOR'S PROPOSAL</u>			<u>RESULTS OF AUDIT</u>	
	COST	FEE/ PROFIT	PRICE/ AMOUNT	RECOM- MENDED COST	REFERENCE
CPFF					
Net Increase (Decrease)	\$ _____	\$ _____	\$ _____	\$ _____	
CPIF					
Net Increase (Decrease)	\$ _____	\$ _____	\$ _____	\$ _____	
FPI					
Net Increase (Decrease)	\$ _____	\$ _____	\$ _____	\$ _____	
FFP					
Net Increase (Decrease)	\$ _____	\$ _____	\$ _____	\$ _____	

- The report will be consistent with those used for all pricing proposal audit reports. Separate notes or schedules will show detail of cost impact computations.
- Comments relating to profit and potential offsets may be made as an explanatory note or included in a report appendix. However, specific recommendations on profit and offsets should not be made.

10-900 Section 9 --- Audit Reports on Contract Audit Closing Statements, Other Contract Closings, and Price Redeterminations

10-901 Introduction

a. This section provides guidance for the preparation and distribution of:

- contract audit closing statements (CACS) on cost reimbursement and time and material type contracts and subcontracts, whether issued as a written report or an electronic data transmission; and
- repricing proposals for incentive and price redeterminable fixed-price contracts.

b. Guidance involving requests for contract audit closing statements for non-DoD agencies is in 15-103. Guidance on assist reports to other contract auditors is in 6-800. Further guidance concerning processing completion vouchers is in 6-1000.

c. Generally, contract closeout audits are administrative in nature. The audit work performed and opinion on the allowable contract costs are contained in the annual audit of the contractor's incurred costs. If these audits have not yet been performed, the contract generally cannot be closed out unless the periods unaudited qualify for quick closeout as discussed in 6-1010.

d. A single audit report may be issued on each contract or on a group of contracts. If a single audit report is issued on more than one contract, coordinate with the contracting officer on needed report information prior to issuing the report. If available, use the Cumulative Allowable Cost Worksheet (CACWS), or a comparable worksheet, as the source for the information to complete the Contract Audit Closing Statement (CACS). In most instances, the CACWS should be acceptable to the ACO to close contracts without the need for a traditional CACS (see 6-711.3).

10-902 Cumulative Allowable Cost Worksheet (CACWS), Comparable Worksheets, or Contract Audit Closing Statement Reports (CACS)

Completed contracts should be closed by one of these methods (in order of preference):

- (1) issuing a CACWS (see 6-711.3) without a traditional final written CACS report, if acceptable to the ACO;
- (2) issuing one closing audit report for multiple contracts; or
- (3) issuing an audit closing statement for each contract.

a. The contract audit closing statement or CACWS is usually the final report to be submitted upon completion or termination of a cost-reimbursement or time and material type contract or subcontract.

b. Some contracts have numerous task orders, sub-line items, or other separate portions that are separately funded. If the customer agrees, it is frequently more efficient to issue a single contract audit closing statement or CACWS with a listing of cost data by separate task order, line item or funding provisions. This is an acceptable alternative to issuing a separate report for each task order or line item number. Such a consolidated report must provide all pertinent information for each task order or line item number being closed.

c. Generally, the contract audit closing statement contains the following sections:

- Cover Sheet
- Subject of Audit
- Scope of Audit
- Results of Audit
- DCAA Personnel and Report Authorization
- Audit Report Distribution and Restrictions.

The "shell" report and the audit program are available on the Audit Planning and Performance System (APPS) and the DCAA Intranet. Some additional considerations for the Scope of Audit and the Results of Audit sections are presented below.

d. Subject of Audit. The purpose of the audit is to verify the contractor's assertion that costs claimed represent allowable costs and fee for the contract. Briefly state information which is pertinent to the closing of the contract such as contract number, final voucher number, dollar amount of contract, description of

work performed, and the period of contract performance.

e. Scope of Audit. Generally, the traditional scope paragraph (see 10-210.3) is appropriate. The following information or pertinent comments should be provided in the "Qualifications" paragraph when significant and appropriate.

(1) A brief statement should be made of any deficiencies in the contractor's accounting procedures, with the auditor's recommendations for corrective actions. (Note that such deficiencies should be identified as qualifications only when the cost impact cannot be determined. If the impact can be determined, the deficiency would be reported in the Results of Audit section of the report.) This is necessary only where the contractor has other continuing auditable contracts or is expected to be awarded such contracts in the near future.

(2) When the cost impact cannot be determined, provide a statement of status of any unsettled disapprovals, outstanding sub-contract legal actions, open insurance claims, or other unresolved items of which the auditor has knowledge. When the cost impact is known, this statement belongs in the Results of Audit section of the report.

(3) When quick closeout procedures are being used, make a brief statement that the audit was performed in response to (a) the contractor's request for final payment, or (b) the contracting officer's request for assistance in closing out the contract (sub-contract) using administrative quick closeout procedures under FAR 42.708. This should be followed by statements on what fiscal years have been audited and which have not been audited. See 10-903 for suggested wording.

f. Results of Audit. The audit results should begin with the phrase, "In our opinion, . . ." and should comment on the following items:

(1) The overall allowability of the costs claimed by the contractor (when applicable, also comment on allowability regarding particular contract terms on cost such as task/delivery order limitations, ceiling rates, not to exceed costs, or other special cost provisions within the contract);

(2) Any contractor operations pertinent to cost sharing affecting final settlement of the contract;

(3) The impact of appropriate Qualifications;

(4) Any unclaimed wages, unclaimed deposits, unpresented checks, and potential credits and refunds.

(5) If government funds were advanced to finance the contractor's operations, a statement should be made of the unliquidated balance of the advance, after all adjustments and any unpaid interest charges on such funds or contractor's failure to replace funds expended for disapproved expenditures.

(6) When the work contemplated by the contract has not been physically completed, the auditor should comment upon this situation so that the contracting officer may determine whether an adjustment should be made in the fixed fee payable under the contract.

(7) When government furnished material or equipment is furnished to the contractor in amounts greater than contemplated by the terms of the contract, thereby relieving the contractor of the responsibility of furnishing the items, the matter should be commented on, in order that the contracting officer may determine whether the contractor is entitled to the stipulated fee. Additionally, if the contract provides for cost-sharing or participation by the contractor in cost savings, the auditor should indicate that part of the cost savings resulting from this factor.

(8) If an exit conference was conducted, follow the guidelines presented in 10-210.5e. If an exit conference was not conducted, include a statement explaining the circumstances. For example, a statement might read:

"An exit conference was not conducted because [*provide reason.*]"

10-903 Quick Closeout Procedure Reports

The auditor should issue a contract audit closing statement when (i) a contractor requests final payment on a contract meeting the criteria for quick closeout under FAR 42.708 (also see 6-1010) and (ii) the contracting officer requests DCAA's advice regarding the final payment and use

of quick closeout procedures. This is an application of agreed-upon procedures; follow the guidance in 10-1000 as supplemented in the following paragraphs.

When preparing the closing statement in this situation, the report will clearly indicate what costs and fiscal periods have been audited and which have not been audited. Suggested wording for the "Scope" paragraph follows:

"This application of agreed-upon procedures is in response to your request for assistance in closing out the contract using the administrative quick close out procedures under FAR 42.708. The costs of \$__ claimed on the subject contract represent costs recorded for the contract during FYs 1999-20X1. Of this amount, \$__ represents amounts incurred during FYs 1999-20X0. We have completed the annual audits of incurred cost for these years. The remaining claimed costs of \$__ were recorded during FY 20X1. The audit of [*contractor's name*] FY 20X1 incurred costs is in process. We do not expect that the FY 20X1 audit results will find a significant exception to the claimed costs."

10-904 Repricing Proposal Reports for Incentive and Redeterminable Fixed-Price Contracts

a. The audits of incurred costs under repricing proposals for incentive (FAR 16.403) and redeterminable (FAR 16.205) fixed-price contracts are similar to other contract closeout audits, therefore, a similar closeout report is generally appropriate.

b. Because of the nature of such contracts, (cost/performance incentives and/or prospective/retroactive redetermination) the auditor should coordinate with contracting officials early -- to plan the audit and the report -- to be responsive to customer needs. In cases where the contract provides for an incentive fee based in part upon performance or quality, coordination is essential to obtain technical information to determine the contract fee.

c. The Scope of Audit section should address the applicable Qualifications listed above (10-902e.), as well as any pertinent qualifications involving incentive fee and profit computations.

d. The Results of Audit section would be generally consistent with the guidance above (10-902f.) and include a specific recommendation on incentive fee and profit computation. Other pertinent comments might include:

- Cost sharing provisions
- Outstanding Form 1s
- Warranty clauses
- Make or Buy decisions
- Subcontracts -- cost pyramiding
- Contractor overpayments

10-905 Report Distribution – CACS and Repricings

a. Contract audit closing statement shall be distributed as follows:

(1) Closing statements other than in (2) through (6) below will be submitted to the administrative contracting officer.

(2) Closing statements for terminated contracts will be submitted to the termination contracting officer. The closing statement should be issued no later than the submission date of the advisory audit report on the contractor's termination settlement proposal.

(3) Closing statements related to NASA contracts will be sent to the cognizant contracting officer. If requested by NASA, furnish a copy to the NASA Office of Inspector General, Assistant IG for Auditing. (See Supplement 15-1S1.)

(4) For the Department of Health and Human Services (DHHS), closing statements will be submitted to the DHHS Inspector General office that requested the audit.

(5) Reports issued on AID contracts should be addressed to the Office of Regional Inspector General/Audit/ Washington, Room 514 RPE, Agency for International Development, Washington, DC 20523 (see 13-706.4).

(6) Reports related to National Guard Bureau contracts will be issued to the United States Property & Fiscal Officer (USP&FO) designated as the contracting officer (14-903.5).

July 2003

**10119
10-905**

b. Where the completion voucher and related closing documents (original and six copies) have not been previously submitted to the ACO/TCO, they should be forwarded by transmittal memorandum at the conclusion of the closing statement, but not as part of the closing statement. This will expedite

electronic transmission of the closing statement.

c. Reports for repricing proposals will be submitted to the requesting ACO/PCO and other appropriate recipients.

d. All report recipients will be identified in the Distribution section of the report.

10-1000 Section 10 --- Reports on Application of Agreed-Upon Procedures

10-1001 Introduction (Agreed - Upon Procedures)

This section provides guidance for preparing reports on application of agreed-upon procedures to contractor submissions. Government Auditing Standards have incorporated Statements on Standards for Attestation Engagements (SSAE) in guidance covering fieldwork and reporting on applications of agreed-upon procedures.

10-1002 Nature of Reports (Agreed - Upon Procedures)

a. DCAA is authorized to accept agreed-upon procedures engagement requests for any financial-related assignment if (1) meaningful measurement criteria such as FAR, DFARS, CAS, GAAP, or other relevant standards exist, and (2) the requestor and DCAA agree as to the procedures to be applied.

b. Auditing standards require that the auditor establish a clear understanding regarding the terms of the engagement. DCAA auditors should accomplish this through an acknowledgement letter (see 4-103d.) tailored to the specific procedures agreed upon for the assignment. If the initial request is unclear, the acknowledgement letter should not be issued until after DCAA and the requestor have discussed the requirements further and have reached an understanding of the procedures to be applied.

10-1003 Report Format and Contents (Agreed - Upon Procedures)

a. In an agreed-upon procedures engagement, an auditor is asked by a requestor to issue a written report covering findings arising from clearly identified procedures performed on another party's written assertions, such as claims or other submittals, documents, or records. The auditor may issue such a report only if standards exist which can objectively measure the assertion's validity.

b. Prepare reports following the standard aspects of report preparation (see 10-200) and the professional standards for

reporting (see 2-400). The auditor will also be guided by the reporting concepts for the assignment types discussed in 10-400 through 10-1200 and the information below. The report should contain all necessary and pertinent information to be fully responsive to the needs of the recipient.

c. Reports should be prepared using the following format:

Cover Sheet

Report Narrative

Subject of Application of Agreed-Upon Procedures

Executive Summary

Scope of Application of Agreed-Upon Procedures

Restrictions on Procedures

Results of Application of Agreed-Upon Procedures

Disclaimer of Opinion

Exhibits and Schedules

Additional Remarks

Contractor Organization and Systems

DCAA Personnel and Report Authorization

Report Distribution and Restrictions

Appendixes, if needed.

10-1004 Report Narrative (Agreed - Upon Procedures)

a. An application of agreed-upon procedures does not constitute an examination or a review. However, it is more than merely providing specific cost information. Our report provides an evaluation of contractor data measured against agreed-upon criteria. The requestor selects these criteria to achieve an intended purpose. The report number, the report title, the section headings, and the report header are revised to delete the word "Audit." Include the words "Application of Agreed-Upon Procedures" in the section headings. The separate report sections should be tailored to describe the agreed-upon procedures performed. The use of the term "engagement" is more appropriate to describe the work performed by DCAA. The nature of the engagement should be described in terms of "evaluation" and "analysis," rather than using the term "audit" or expressions reserved for

audits such as “examination” or “review.” Likewise, the results should be expressed in terms of “adjustments,” “recommendations” or “findings,” rather than “questioned cost.”

b. Generally accepted government auditing standards incorporate the AICPA’s attestation standards, including standards for applications of agreed-upon procedures. An application of agreed-upon procedures performed in accordance with SSAE No. 4 is therefore considered an engagement performed in accordance with generally accepted government auditing standards. However, the engagement is not considered an examination because of the limitations on the audit scope (see 2-104d.). The Results of Application of Agreed-Upon Procedures section will begin by disclaiming an opinion on the elements evaluated. The body of the narrative will state each procedure and the related findings. If other matters known to DCAA, such as a significant internal control deficiency or a CAS or FAR violation might significantly affect the objectives of the evaluation, the matter should be explained in the report narrative or an appendix.

c. The report will provide neither positive assurance regarding any contractor representations nor negative assurance that nothing came to DCAA’s attention that caused us to believe that the assertion is not fairly stated. Reporting standards for financial-related audits require application of agreed-upon procedure reports to include a statement such as, “had we performed additional procedures, other matters might have come to our attention that would have been reported to you.” This statement does not constitute negative assurance.

10-1005 Subject of Application of Agreed - Upon Procedures

The subject paragraph, modified for the application of agreed-upon procedures, may read:

“As requested by [*requestor organization name*] in a memorandum dated [*date*], reference [*requestor’s reference number*], and

as discussed subsequently with your office, we applied agreed-upon procedures to the [*subject matter of contractor assertion*] of [*contractor name*] for contractor fiscal years 19XX through 20XX. The purpose of our engagement was to. . .”

When the auditor participated as a member of an IPT, the subject paragraph should include the following statement:

“As requested by [*requestor organization name*] in a memorandum dated [*date*], reference [*requestor’s reference number*], and as discussed subsequently with your office, we applied agreed-upon procedures to the [*subject matter of contractor assertion*] of [*contractor name*]. The contracting officer formed an Integrated Product Team (IPT) to effectively and efficiently manage the subject acquisition. At the request of the contracting officer, as part of the agreed-upon procedures accomplished, DCAA participated as a member of the IPT.”

[Note that the second paragraph regarding responsibility is omitted (see 10-210.1) because an audit is not being performed.]

10-1006 Executive Summary (Agreed - Upon Procedures)

Due to the limited nature of the agreed-upon procedures, this section usually is not needed. However, an Executive Summary should be used if it is necessary to direct the user’s attention to significant adverse findings addressed in the report.

10-1007 Scope of Application of Agreed - Upon Procedures

a. An agreed-upon procedures engagement is designed to accommodate the specific needs of the parties in interest. The statement of scope must identify the procedures agreed upon between DCAA and requestor.

b. In “examinations” and “reviews,” the criteria against which assertions are evaluated are generally GAAP, FAR/DFARS, and CAS. When these criteria apply to agreed-upon procedures engagements, they should be set out in the scope paragraph. It is possible that additional criteria may also apply. Other regulatory guidance, statutes, and agreements between the government and contractor, which were used as criteria against which an assertion was evaluated, should be referenced here. These would include OMB Circulars at educational and nonprofit organizations, statutes when rendering investigations support, ACO advance agreements, memoranda of agreement, etc.

c. Begin the scope paragraph with the following statement to make clear that the engagement was limited to agreed-upon procedures.

“We have performed the mutually agreed-upon procedures enumerated below solely to assist you in evaluating [*subject matter of contractor assertion*]. This agreed-upon procedures engagement was performed in accordance with generally accepted government auditing standards. The sufficiency of the procedures is solely the responsibility of the requestor. Consequently, DCAA makes no representation regarding the sufficiency of the procedures described below, either for the purpose for which this report has been requested or for any other purpose.”

[Note that the traditional scope paragraphs regarding evaluation criteria and control risk are omitted because an examination or a review is not being performed.]

d. List the specific procedures performed. For example, the listing may read:

“The following agreed-upon procedures were applied:

[*List only the procedures agreed-upon for the application being reported*].

- briefed contract DABT10-92-D-0123;

- evaluated severance pay in accordance with FAR 31-205-6(g);
- reconciled direct costs billed to the general ledger;
- verified billed labor hours to the labor distribution;
- verified billed labor rates to contract terms;
- tested labor code E-3 cost transfers for COTR approval; and

[*If performing a cost realism evaluation, include the following procedure:*]

- evaluated the proposed costs for realism and possible understatement.”

10-1008 Restrictions on Procedures (Agreed - Upon Procedures)

The Restrictions on Procedures section is similar to the qualification section used in audit reports (see 10-210.4). However, a qualification section is not used in agreed-upon procedures engagements because the auditor disclaims an opinion. Reportable restrictions comparable to those in 10-210.4 will be included when necessary to discuss items that have prevented completion of all agreed-upon procedures, or when the application of part or all of an agreed-upon procedure has been limited due to circumstances beyond the control of the auditor.

10-1009 Results of Application of Agreed - Upon Procedures

This section communicates (i) a disclaimer of opinion; (ii) the findings of the agreed-upon procedures performed, and (iii) additional remarks as applicable in the circumstances.

a. Disclaimer of Opinion: Start with a statement that an audit was not performed, a disclaimer of opinion, and a statement that if additional procedures had been performed, other matters might have come to our attention that would have been reported. When the application of agreed-upon procedures discloses significant deficiencies such as inadequate cost or pricing data, internal control deficiencies and/or significant noncompliances with FAR and/or CAS, identify the location in the report that discusses the significant

deficiency. A deficiency that the auditor believes should be called to the user's attention although it is unrelated to a specific agreed-upon procedure, such as inadequate cost or pricing data or internal control deficiencies, may be reported in an appendix. Only a disclaimer of opinion may be rendered in an application of agreed-upon procedure report.

(1) An example of a disclaimer of opinion, which might be used when the application of procedures to evaluate information, other than cost or pricing data, disclosed no significant inadequate information and no noncompliances with FAR and/or CAS, follows:

"This report pertains only to the performance of agreed-upon procedures to evaluate [*briefly specify assertions covered by the engagement*]. We were not engaged to, and did not, perform an examination, the objective of which would be the expression of an opinion on the subject matter of this report. Accordingly, we do not express such an opinion. Had we performed additional procedures, other matters might have come to our attention that would have been reported to you."

(2) An example of a disclaimer of opinion which might be used when the application of the procedures to evaluation of information, other than cost or pricing data, disclosed significant noncompliances with FAR and/or CAS, follows:

"This report pertains only to the performance of agreed-upon procedures to evaluate [*briefly specify assertions covered by the engagement*]. We were not engaged to, and did not, perform an examination, the objective of which would be the expression of an opinion on the subject matter of this report. Accordingly, we do not express such an opinion. As stated in [*report location*], the contractor's accounting system does not accumulate data necessary for the evaluation of labor transfers. Had we performed additional procedures, other matters might have come to our atten-

tion that would have been reported to you."

b. Exhibits and Schedules: The next part of the "Results" section should describe the contractor books and records to which agreed-upon procedures were applied. The results should be presented in an exhibit type format that identifies or references the procedures performed with the related findings. Appropriate explanatory notes should be provided. While exhibits and explanatory notes in agreed-upon procedure reports are usually not as extensive as those in audit reports, the general guidelines for preparation of exhibits and notes (see 10-210.5) and in the applicable audit area (see 10-300 through 10-1200), may be used as a reference. The goal is to clearly and concisely explain the findings to the requestor.

c. Cost Realism: The report should clearly indicate that the contractor's proposed costs were specifically evaluated for realism and possible understatement. Given the nature of cost realism analyses, when significant rates or costs are found to be underbid during these types of agreed-upon procedures evaluations, it is appropriate to include an exhibit summarizing understated rates or costs. Additional information on cost realism may be found at 9-311.4.

d. Additional remarks: Indicate the date an exit conference was held and the name and title of the contractor's designated representative with whom the exit conference was conducted (see 4-304). Also briefly describe the contractor's reaction in this section. Where appropriate, detailed comments on the contractor's reaction to the report findings will be included in the explanatory notes. When the contractor provides a formal, written response, it should be referenced within the Results of Application of Agreed-Upon Procedures section and included as an appendix to the report. Further remarks should be included when appropriate to the circumstances. For example, include remarks if information in the report was provided to the contracting officer in advance by telephone or if significant internal control deficiencies relevant to the elements being reported on have been previously identified and reported, but not yet resolved.

**10-1010 Contractor Organization and
Systems (Agreed - Upon Procedures)**

Follow the general guidelines (see 10-210.7) to prepare comments regarding the contractor organization and systems section of the report.

**10-1011 Report Distribution and
Restrictions (Agreed - Upon Procedures)**

Restrictions paragraph 4 should be revised as follows:

“This report was prepared using procedures agreed upon by the identified requestor. The reported findings do not include an audit opinion. The information contained in this report is intended solely for the use of the identified recipients, and should not be used by them or by others for any purpose other than that for which the procedures were established.”

10-1100 Section 11 --- Audit Reports on Price Adjustment Proposals or Claims**10-1101 Introduction (Claim Reports)**

a. This section provides guidance for preparing reports on price adjustment proposals or claims. For additional significant report requirements on price adjustment proposals and claims, refer to 12-800.

b. A requestor may ask DCAA to evaluate limited portions of contractor price adjustment proposals or claims by means of agreed-upon procedures. Agreed-upon procedures are appropriate when objective evaluation criteria exist and the auditor and requestor reach mutual agreement on the procedures to be applied. Guidance in 10-1000 should be followed, modified as necessary to conform to the requirements of price adjustment reports. The auditor should ensure that:

- the acknowledgment indicates the parties have reached a clear understanding regarding the terms of the engagement (see 4-103.d.);
- the report does not refer to the engagement as an “examination” or a “review;”
- the report disclaims an opinion; and
- the restrictions are appropriate for agreed-upon procedures (see 10-1008).

c. Because of the sensitivity of a claim and the possibility that it will become the subject of litigation, it is unlikely that a requestor will want to limit the evaluation to a review. However, the evaluation of a claim may be performed as a review if necessary to meet time constraints or other special needs of the requestor. Modify the subject, scope and opinion paragraphs as shown in 10-210.

d. While it is possible to evaluate a portion of a claim using the standards for an audit, either an examination or a review, it may be inadvisable to do so. The elements of the claim may be highly interconnected. Should the FAO receive a request for an audit of part of a claim, the specific issues to be addressed should be analyzed, and a determination made as to whether the elements covered by the request may be evaluated on a stand-alone basis. The analysis should be documented in the working papers.

10-1102 Proper Terms (Claim Reports)

a. For price adjustment proposals, incorporate in the resulting audit report the terms “negotiation” and “Truth in Negotiations Act” as if the submission were a price proposal (a pricing action). Since a claim is no longer considered a pricing action, the appropriate terms cited in these cases are “adjudication” or “settlement” versus “negotiation.” Refer to the correct type of submission; e.g. a price adjustment proposal or a claim, when the submission meets the requirements of FAR 33.201. Refer to 12-504 for further guidance.

b. Some pro forma comments used in price proposal reports are not suitable for claim reports. When the audit concerns a claim being appealed to the ASBCA or courts, do not refer to pricing terms that apply to expected negotiations. In particular, question costs for lack of support rather than classifying them as unsupported, because claim audits generally deal with after-the-fact costs. Also, do not refer to 10 U.S.C. 2306a on claims required to be certified by the Contract Disputes Act of 1978 (use 41 U.S.C. 601).

10-1103 Report Format and Contents (Claim Reports)

a. Since claims often involve legal issues and frequently are complex, the audit report must be sufficiently clear, complete and accurate to withstand the rigors of the appeal process.

b. The nature and extent of detail in the report depends on (1) the complexity of the proposal or claim, (2) the significance of errors or omissions, (3) the materiality of the auditor's recommended adjustments, (4) results of discussions with the contractor, and (5) the contracting officer's specific requests.

c. The minimum data requirements stated in 10-1105.1 apply, even if the audit did not result in questions regarding the contractor's submitted costs or other qualitative or quantitative aspects. Also include in the report the information stated in 10-1104, regardless of the audit findings.

10-1103.1 General Format

Prepare the report following the guidance in 10-100 and 10-200, as supplemented by this section. The general arrangement of report contents follows:

- Audit Report Cover Sheet (10-205)
- Report Narrative (10-210)
 - Subject of Audit (10-1104.1)
 - Executive Summary (10-1104.2)
 - Scope of Audit (10-1104.3)
 - Qualifications (10-1104.4)
- Results of Audit (10-1105)
 - Opinion (10-304.6)
 - Exhibits and Schedules (10-1105.1)
 - Unsatisfactory Conditions and/or Other Audit Recommendations (4-800)
 - Additional Remarks (10-1105.3)
- Contractor Organization and Systems (10-1106)
- DCAA Personnel and Report Authorization (10-211)
- Report Distribution and Restrictions (10-212)
- Appendixes (10-1107)

Following the general format in 10-205, include the title "Report on Price Adjustment Proposal" or "Report on Price Adjustment Claim" on the subject line. Also include the prime contract number on the reference line; and the contractor's name, city, and state on the contractor line.

10-1103.2 Addressing and Distributing Reports

The general policy for addressing audit reports is stated in 10-206; for report distribution, in 10-212. For all reports covered by this section, include the onsite FLA (refer to 15-3S1) in the distribution. Follow the guidance in 10-212.2 on the release of draft audit reports to the contractor. For reports on those claims appealed to a BCA or court, coordinate the release of the report with the government trial attorney.

10-1104 Report Narrative

The body of the report will contain the following paragraphs, as applicable. (See 10-210 for paragraph format.)

10-1104.1 Subject of Audit

The first paragraph under this heading should identify the type of submission and purpose of the audit. It should state the contract type, incentive provisions, total value of the submission, and whether the submission represents a price adjustment proposal, or a claim under the Contract Disputes Act of 1978. Also include a statement that the submission is the responsibility of the contractor and that the auditor's responsibility is to express an opinion based on the audit [see 10-210.1b.(1)]. Add other appropriate information as necessary.

10-1104.2 Executive Summary

This section is intended to give the reader a brief overview of the audit findings -- audit opinion, recommendations and the significant issues supporting the opinion. Follow the guidelines presented in 10-210.2 and 10-304.2.

10-1104.3 Scope of Audit

a. Include the following scope of audit statement as a separate paragraph, modified as shown where appropriate. This section should also be used to provide information regarding advance agreements and special contract provisions having a bearing on the proposal or claim.

"Except for the qualification(s) discussed below, [omit if there is no "Qualification(s)" section within the "Scope" paragraph], we conducted our examination in accordance with generally accepted government auditing standards. Those standards require that we plan and perform the examination to obtain reasonable assurance that the price adjustment proposal (*claim*) is free of material misstatement. An examination includes:

- evaluating the contractor's internal controls, assessing control risk, and determining the extent of audit testing needed based on the control risk assessment;
- examining, on a test basis, evidence supporting the amounts and

disclosures in the price adjustment proposal (claim);

- assessing the accounting principles used and significant estimates made by the contractor;
- evaluating the overall price adjustment proposal (claim) presentation; and
- determining the need for technical specialist assistance [*and quantifying the results of a government technical evaluation*].”

b. The next paragraph should identify the established or stated criteria used to evaluate the proposal or claim. (See 10-210.3c.). For CAS covered contractors, if the subject contract is exempt from CAS for any of the reasons identified in 48 CFR 9903.201-1, state this fact in the report (see 10-210.3d.). For example:

“Contract number N00019-XX-C-1234 is not covered by Cost Accounting Standards Board rules and regulations because it is a sealed bid contract and is therefore exempt from all CAS requirements under 48 CFR 9903.201-1(b)(1).”

c. The last paragraph in the Scope of Audit section should describe the impact of the current assessment of control risk on the audit scope. (See 10-210.3e.).

10-1104.4 Qualifications

a. Include this section only if qualifying the audit opinion due to limitations related to the stated purpose and scope of audit (see 10-304.4). In such a case, both the “Scope of Audit” and the “Results of Audit” must specifically refer to this section. (Properly explain any unqualified audit conclusions and recommendations in other portions of the report. Do not refer to them in this part of the report.)

b. This section must clearly explain the nature and potential impact of each circumstance that prevents an unqualified opinion, and any steps taken to overcome or mitigate the problem. If applicable, also explain any further action that the auditor will take after issuing the report.

c. For situations involving several circumstances, use separately numbered subparagraphs for each qualification (e.g., contractor's denial of access to records or inadequate contractor cost records).

d. Indicate in this section that the results of audit are based on the contracting officer's determination that the submittal is a price adjustment proposal or a CDA claim. Should this determination be changed, suggest that the auditor be notified so that the impact of such a change on the results of audit can be assessed. See 12-504d. and 12-504e. for guidance.

10-1105 Results of Audit (Claim Reports)

a. This section should begin with the phrase, “In our opinion. . .” and should present the audit opinion (qualified, if appropriate) and refer to applicable exhibits, schedules, and appendixes. (See 10-304.5).

b. Reporting standards (see Chapter 2) require an opinion on the adequacy of submitted cost or pricing data and their compliance with FAR and Cost Accounting Standards where such regulations and standards apply. See 10-304.6c for guidance on developing an opinion.

c. Claims or proposals that include significant questioned costs, including costs questioned for lack of support, may warrant an adverse audit opinion (see 10-304.6). Express an adverse opinion when the contractor should take some specific corrective action before the government can consider the claim or proposal and related material as an adequate basis for adjudication, settlement or negotiation of a price adjustment (see 9-212.3).

10-1105.1 Exhibits and Schedules

a. Use an exhibit to summarize the proposal or claim as part of the results of the audit (see 10-304.7). Include structured notes to give the reader a comprehensive understanding of the basis of the proposal or claim and, if applicable, the reasons for the auditor's use of a different method to determine a price adjustment. Present important dates in an appendix titled “Chronology of Significant Events” (10-1107.1).

b. Results of audit of the Eichleay formula (see 12-805) should be presented in the report exhibit or a structured note, and should include: (a) the contractor's computations; (b) the audit computations; (c) discussion of the basis for the differences by each element of the formula; and (d) any audit adjustments to the computed damages. See 12-806 for further guidance.

10-1105.2 Unsatisfactory Conditions or Other Audit Recommendations

Use this section to report any unsatisfactory conditions or questionable practices relating to the contractor's operations and the contract being audited. Whether the auditor should include a particular condition or practice in this section depends on its significance and the frequency of previous reporting. When the audit of a contractor's or subcontractor's records or information from other sources suggest fraud, other criminal activity, or the existence of unsatisfactory conditions, send a referral as provided by 4-700 or 4-800 (whichever is more appropriate in the circumstances).

10-1105.3 Additional Remarks

Conclude the Results of Audit section of the report narrative with the following additional remarks, as appropriate.

a. Exit Conference (see 10-210.5e.(1) and (2))

(1) In all evaluations, state the date and the name and title of the contractor's designated representative with whom the results of audit and/or the factual matters were discussed (see 4-304).

(2) In addition, if there were findings, summarize the contractor's reaction to the audit results and/or factual matters, the major areas of difference likely to be pursued at negotiations, and any other comments relevant to resolution of the findings.

(3) When the contractor provides a formal, written response, it should be referenced within the Results of Audit section and included as an appendix to the report. Include any rebuttals in the "Auditor's Response" portion of the explanatory notes. Include the following statement.

"The complete text of the contractor's response appears as Appendix [X]."

(4) If the contractor provided no response, the following is an example of a statement that is permissible but not required.

"[Identify the contractor representative] reserved comment pending discussions with the cognizant Federal agency official."

(5) An illustration of a report paragraph is shown below:

"We discussed the results of audit with [identify the contractor representative(s) by name and title] in an exit conference held on [date]. [If there are projected estimates for future work, do not disclose the audit results on these projections, disclose only factual matters and include the following as the second sentence: During the exit conference we disclosed only factual matters regarding the estimates for future work not completed.] [Include a summary of the audit results and/or factual matters.] In response to our findings [include a summary of the contractor's reaction to the audit results and/or factual matters.] The complete text of the contractor's response appears as Appendix [X]. [Include the auditor's rejoinder to the audit results and discuss the validity of the contractor's response.]"

b. Per 12-507, draft and final audit reports on equitable adjustment claims should not be provided to the contractor unless the contracting officer or government trial attorney authorizes the release in writing.

c. Use the guidelines provided in 10-210.5e.(2) to prepare other addition remarks.

10-1106 Contractor Organization and Systems (Claim Reports)

Include relevant information, which impacts the scope and the results of the

audit. Tailor it to the contractor's size and where possible reference previous reports. Follow the guidelines in 10-210.7.

10-1107 Appendixes (Claim Reports)

Use an appendix only for required supplementary or supporting information, as explained in 10-213. The report body, exhibit, or schedule should refer to any appendix included as part of the report. The following should be used for a report on a price adjustment proposal or claim.

10-1107.1 Chronology of Significant Events (See Figure 10-11-1)

a. Include a chronology of significant events as an appendix in each proposal or claim audit report. This appendix lists the significant events leading up to or having a bearing on the proposal or claim. Its purpose is to ensure that the report's recipient and potential users (such as the ASBCA judge and attorneys) have an understanding of the key issues and events.

b. The chronology should show whether the contractor certified the claim under the

Contract Disputes Act, the certification date, whether the contracting officer has made a decision on entitlement, the date and amount of the initial price proposal, the basic contract plus modification amounts, key events regarding contract performance issues, the dates of alleged delays or disruptions, performance dates anticipated at award date, and actual performance dates.

10-1107.2 Contractor's Written Comments

Include as an appendix a copy of the contractor's written comments submitted in response to the exit conference (see 10-1105.3).

10-1107.3 Observations on Entitlement

Include in an appendix on "other matters" any observations that relate to the contractor's assertion of entitlement (see 12-701 and 12-802.1), such as evidence of delays caused by contractor delays in ordering materials, subcontractor caused delays, or malfunctioning machinery.

Figure 10-11-1 (Ref. 10-1107.1)
Evaluation of Proposal or Claim for Price Adjustment

Audit Report No. _____

APPENDIX 1

EVALUATION OF PROPOSAL OR CLAIM FOR PRICE ADJUSTMENT

Filed under Changes Clause () or Disputes Clause (x)

Contract No. N00999-92-C-1234

Board of Appeals Case No. 33333

Contractor Name	<u>XYZ Company</u>	Telephone	<u>(703) 274-7775</u>
Outside Proposal or Claim Preparer	<u>Samuel Jones</u>	Telephone	<u>(703) 274-7776</u>
Trial Attorney Name	<u>Portia Barrister</u>	Telephone	<u>(202) 514-0832</u>
Date of Initial Price Proposal	<u>Aug. 21, 1992 (compet. bid)</u>	Amount	<u>\$1,000,000</u>
Date of Basic Contract	<u>September 30, 1992</u>	Amount	<u>\$1,000,000</u>
Contract type	<u>Firm-Fixed-Price Competitive</u>		
Total Amount of All Modifications	<u>\$500,000</u>		
Date(s) of Alleged Abnormal Condition(s)	<u>October 1, 1992 - January 15, 1994</u>		
Description:	XYZ Company alleges that the government provided defective specifications and equipment, which resulted in increased cost.		
Contract Specified Performance Dates:	From: <u>October 1, 1992 to: September 30, 1993</u>		
Actual Performance Dates:	From: <u>January 29, 1994 to: September 30, 1996</u>		

CHRONOLOGY OF SIGNIFICANT EVENTS

<u>Event</u>	<u>Date</u>
Contractor alleges defective specifications	Oct. 1, 1992
Contractor submits site drawings	March 15, 1993
Contracting officer rejects drawings as nonconforming to contract specifications	March 16, 1993
Contractor protests PCO's actions, requests 180-day delay	March 17, 1993
Contracting officer rejects contractor's request	June 27, 1993
Contractor submits revised drawings	Aug. 24, 1993
Contracting officer approves revised drawings	Nov. 22, 1993
Contractor alleges defective GFE	Jan. 10, 1994
Contracting officer notifies contractor of proposed termination for default	Jan. 15, 1994
Performance begins; TFD withdrawn	Jan. 29, 1994
Contractor submits price adjustment proposal	April 22, 1994
Claim submitted	Aug. 22, 1996
Claim certified under Contract Disputes Act	Aug. 22, 1996
Contracting officer determines contractor is not entitled to a price adjustment and issues final decision	Aug. 24, 1996
Contractor files ASBCA appeal	Nov. 23, 1996
Audit request	Nov. 29, 1996

10-1200 Section 12 --- Reports on Other Areas**10-1201 Introduction (Other Reports)**

a. This section provides guidance for preparing reports on evaluations of an entity's adherence to specific financial compliance requirements such as Earned Value Management System (EVMS) criteria (see 11-200) and other DoD requirements (see 14-800), and contract audit areas not covered in Sections 3 through 11 of this chapter. Reports on other areas should be adapted to the specific audit performed. "Shell" reports for a progress payment audit and a financial capability audit can be found on the DCAA Intranet and the APPS.

b. Pro forma language for review reports has not been developed because it is unlikely that most of the evaluations listed below would be evaluated under the review standards. Additionally, there is some possibility that certain types of reports could be deemed to be determinations of compliance with law or regulation, and if so, they would be ineligible for reporting as a review. Should it become necessary to report results of an evaluation subject to this section as a review and review reporting language has not been furnished in the appropriate "shell" report on the APPS, modify the report to use review reporting language outlined in 10-200. Furnish a copy of the report to Headquarters, Attention PAS.

10-1202 Additional Guidance (Other Reports)

a. The principal audit areas to which the guidance in this section is applicable are listed below. The auditor should refer to the identified section for guidance on performing each type of evaluation, and to 10-212 for general guidance on report distribution.

- (1) Audit Reports Pertaining to Suspected Fraud and Unlawful Activity (see 4-702.5).
- (2) Voluntary Disclosure Program (see 4-707.3).
- (3) Voluntary Refunds (see 4-802.4).

- (4) Contractor Financial Capability Reporting Requirements (see 14-309).
- (5) Progress Payments (see 14-206).
- (6) Contract Funds Status Reports (see 11-303.5).
- (7) Cost Performance Reports (see 11-304.4).
- (8) Cost/Schedule Status Reports (see 11-305.4).
- (9) Contractor Cost Data Reports (see 11-306.9).
- (10) Contractor Records of Government Property (see 14-408).
- (11) Military Dependents Medical Care Program (see 14-902.3).
- (12) Advance Payments (see 14-904.4).
- (13) Special Audits Related to Government Rights in Inventions (see 14-906.4).
- (14) Special Information Reports for NASA (see 15-106.4).
- (15) Specific information requirements for reports under Agency for International Development contracts (see 15-107 and 13-706.4).
- (16) Earned Value Management Systems (see 11-209).
- (17) Performance Based Payments (see 14-910).
- (18) Quarterly Limitation of Payments (QLOP) (see 11-105).

b. A requestor may ask DCAA to evaluate limited portions of the above subject matter by means of agreed-upon procedures. Agreed-upon procedures are appropriate when objective evaluation criteria exist and the auditor and requestor reach mutual agreement on the procedures to be applied. Guidance in 10-1000 should be followed, modified as necessary to conform to the subject matter of the report. The auditor should ensure that:

- the acknowledgment indicates the parties have reached a clear understanding regarding the terms of the engagement (see 4-103.d.);
- the report does not refer to the engagement as an "examination" or a "review";
- the report disclaims an opinion; and
- the restrictions are appropriate for agreed-upon procedures (see 10-1008).

10-1203 Report Format and Contents (Other Reports)

Prepare reports following the standard aspects of report preparation in 10-200 and the professional standards for audit reporting in Chapter 2. The auditor will also be guided by the reporting concepts contained in Sections 2 through 11 of this chapter and the comments that follow. The report should contain all necessary and pertinent information to be fully responsive to the needs of the recipient. Reports should be prepared using the following format:

- Cover Sheet (10-205)
- Report Narrative (10-210)
 - Subject of Audit (10-1204.1)
 - Executive Summary (10-1204.2)
 - Scope of Audit (10-210.3)
 - Qualifications (10-210.4)
 - Results of Audit (10-1204.5)
 - Opinion
 - Exhibits and Schedules
 - Additional Remarks
(10-210.5e)
- Contractor Organization and Systems
(10-210.7)
- DCAA Personnel and Report
Authorization (10-211)
- Report Distribution and Restrictions
(10-212)
- Appendixes, if needed.

10-1204 Report Narrative (Other Reports)

Since this section applies to a variety of audit areas, it is imperative that the "Subject of Audit," "Scope of Audit," and the "Results of Audit" paragraphs be tailored to meet the specific requirements of the audit. Be sure the report does not imply acceptance for purposes other than those intended. For example, a progress payment audit report should not be misconstrued as determining the acceptability or allowability of costs claimed on the contractor's progress payment request.

10-1204.1 Subject of Audit

This paragraph should define why the evaluation was performed. Most of the audits covered in this section are evalua-

tions of a specific contractor submission performed in response to requests. In such cases, the request should be referenced in this paragraph. General guidance is provided in 10-210.1. When the evaluation covers the contractor's compliance with one or more specific laws, regulations, or related requirements, the report format should identify the contractor's implicit assertion that it has complied with the requirements. For example, a report on an examination of compliance with EVMS requirements may read:

"As requested by [*requesting office*] in [*memorandum/letter*] [*reference*] dated __, we examined [*contractor name or short name*]'s integrated management system to assure that the system complies with the financial and accounting data requirements related to the Earned Value Management System (EVMS) guidelines established in DoD 5000.2-R and incorporated in DFARS 252.234-7001. By submitting invoices under contracts subject to EVMS criteria, the contractor asserts that it has complied with these requirements. The purpose of the examination was to test whether the relevant contractor's systems meet the standards established in DoD 5000.2-R during the period (*identify the period covered by the evaluation*)."

"Compliance with DFARS 252.234-7001 is the responsibility of the contractor. Our responsibility is to express an opinion on the contractor's compliance with the requirements of DFARS 252.234-7001 based on our examination."

10-1204.2 Executive Summary

Develop an appropriate Executive Summary paragraph using the guidelines provided in 10-210.2 and 10-304.2.

10-1204.3 Scope of Audit

Develop an appropriate scope paragraph using the guidelines provided in 10-

210.3. The scope paragraph should describe the criteria used to evaluate the contractor's submission and any scope qualifications. Also describe the impact of the assessment of control risk on the audit scope (see 10-304.3c).

10-1204.4 Qualifications

This section sets forth any factors which have a significant adverse impact on the scope of audit and usually result in a qualified report. These circumstances include denial of access to records, non-receipt of a technical evaluation report, insufficient time to perform the evaluation, etc. The section of the report which contains the detailed discussion of the item involved should be referenced (page number, exhibit, or schedule). If the report covers evaluation of a contractor's compliance with a specific law or regulation, end this paragraph (or the Scope paragraph, if there are no Qualifications) with the following statement:

"Our examination does not provide a legal determination on [*short name's*] compliance with [*identify law or regulation*] requirements."

10-1204.5 Results of Audit

a. This section of the narrative tells the report recipient the auditor's opinion and what the audit findings are. If the evaluation was an examination, begin the Results paragraph with the phrase, "In our opinion. . ." Do not use the term "opinion" to describe the results of a review. If required, this paragraph should be supported by exhibits and schedules.

b. Many major government contracts contain clauses requiring an approved Earned Value Management System (EVMS) meeting criteria set forth in DoD 5000.2-R for performance measurement on selected acquisitions (11-200). If the contractor has contracts requiring an approved EVMS, provide an assessment of whether the deficiencies disclosed in the report are likely to materially affect the reliability of the contractor's EVMS. Discuss findings and recommendations relating to the EVMS with the Contract Ad-

ministration Office EVMS monitor and the audit supervisor prior to issuance of the report. Immediately after issuing the report, the auditor should evaluate the impact of these deficiencies on specific contracts requiring an approved EVMS and where significant provide the details in EVMS surveillance reports (11-209.2e.). For example, the systems report might say:

"We believe the deficiencies noted in this report will have a material impact on the reliability of the contractor's Earned Value Management System (EVMS) and on the accuracy of the system's data. Immediately after issuing this report, we will evaluate these deficiencies to determine the impact on specific contracts requiring an approved EVMS and will provide the details in EVMS surveillance reports."

c. Conclude the Results of Audit section of the report narrative with the following additional remarks, as appropriate:

(1) Exit Conference

(a) In all evaluations, state the date held and the name and title of the contractor's designated representative with whom the exit conference was held (see 4-304). The summary might read as follows:

"We discussed the results of [*audit, review, procedures, etc.*] with [*Name and Title of contractor representative*] in an exit conference held on [*Date*]."

(b) Summarize the contractor's reaction to any factual differences. Include the major areas of difference likely to be pursued at negotiations, and any other comments relevant to resolution of the findings.

(c) If the contractor provides a formal, written response, it should be referenced within the Results of Audit section and included as an appendix to the report. Include the following statement:

"The complete text of the contractor's response appears as Appendix [x]."

(2) Other Additional Remarks
Use the guidelines provided in 10-210.5e.(2) to prepare other additional remarks.

10-1204.6 Contractor Organization and Systems (Other Reports)

Follow the guidelines provided in 10-210.7 to prepare comments regarding the contractor organization and systems section of the report.